

Scottish Borders Council  
Pension Fund

# **annual report and financial statements**

for the year to 31 March 2017



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## REPORT BY CHAIRMAN OF PENSION FUND COMMITTEE

### Introduction

Welcome to the Annual Report and Accounts for the Scottish Borders Council Pension Fund for the year ended 31 March 2017. This Annual Report has been produced to provide Elected Members, Scheme Members and Employers and other interested parties with information concerning the administration and performance of the Fund in financial year 2016/17.

### Highlights for the Year

#### Pension Fund Committee/Pension Board

The Pension Fund Committee has worked hard during the year in response to the continually growing governance agenda and increasingly complex pension administration environment that the Fund operates within.

The Committee members have engaged with training events both locally and nationally to expand their knowledge and understanding. The recent local elections has resulted in change of Membership for the Committee going forward but due to the hard work and dedication of the out-going Members the fund is in a strong position.

The Joint meetings of the Committee and Board continued during 2016/17 to be productive and informative due to the positive engagement of all members.

The Investment and Performance Sub-Committee, has met all investment managers twice during the year, which has allowed the committee full scrutiny of funds managed.

#### Investment Assets

Following the strong market recovery and strong performance from key fund managers over the last couple of years, 2016 has proved to be challenging but successful time. The level of volatility across markets, especially global equities has continued to be

unprecedented. Despite this the fund has managed to increase in value by £112m during the year.

The overall performance of the Fund was 21.5% for 2016/17, outperforming the benchmark by 1.0%.

#### Procurement Activity

Following the completion of the Strategic Asset Allocation review 3 new managers were successfully appointed to the Fund. The Fund has also entered an agreement to work along with Lothian Pension Fund to access the Infrastructure market.

#### Cashflow Modelling

Work has continued during 2016 modelling the Funds cashflow position. This work will continue into 2017 as the Fund continues to mature and the balance between contributions and expenditure continues to widen.

#### Pensions Administration

During the year the Pensions Administration Team successfully issued all of the Annual Benefit statements to Employees, by the required deadline, and incorporating the new CARE scheme.

### Acknowledgement

I would like to thank the Members of the Pension Fund Committee, Pension Fund Board, officers within the Council, our investment managers, KPMG and Barnett Waddingham for their hard work during the year and their ongoing commitment to ensuring the Fund's continued success.



**Chairman, Pension Fund Committee  
Scottish Borders Council**

## MANAGEMENT COMMENTARY

### Management and Financial Performance

#### Scottish Borders Council Pension Fund

#### 2016/17 Key Highlights

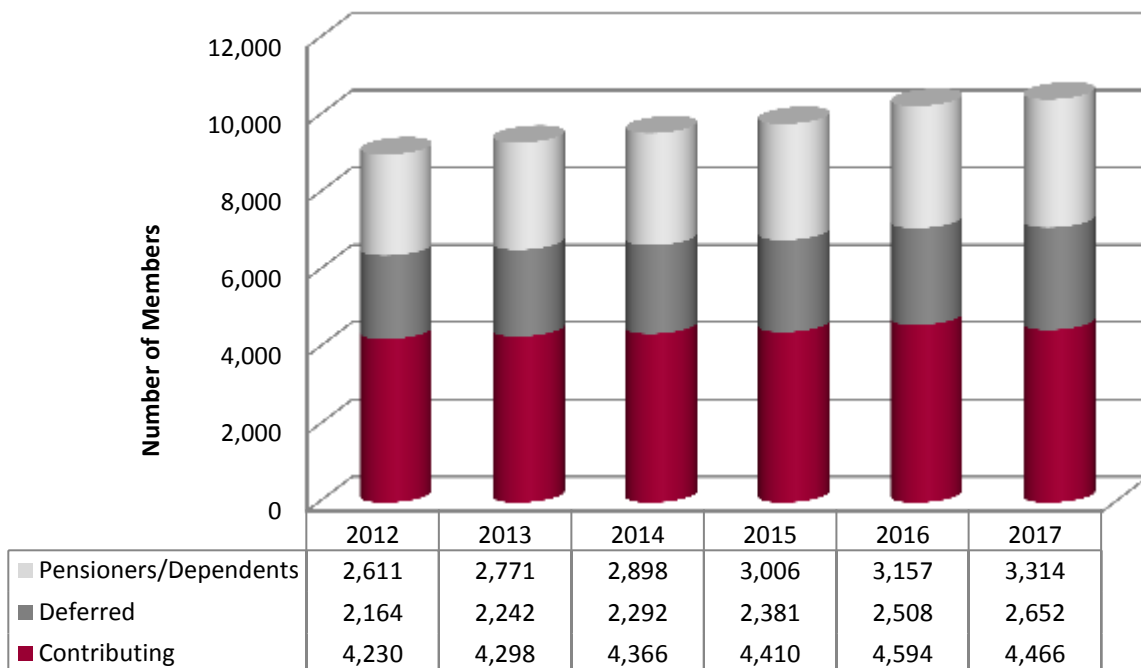
- £654m Net Assets, an increase of £112m on 2015/16
- Strong performance return of 21.5% for 2016/17 and 10.9% for the rolling 3 year period
- Continued sound governance of the Fund and good engagement of Members in the training programme
- 10,432 Members, an increase of 173 on previous year

The Scottish Borders Council Pension Fund (the Fund) as part of the Local Government Pension Scheme (LGPS) is administered by Scottish Borders Council (the Administering Authority). Note 1 to the Annual Accounts, page 28 provides a description of the Fund.

The Note sets out information in relation to the Fund's regulatory environment, funding, benefits and membership.

#### Overview of Fund Membership

Current membership of the Fund is 10,432 of which 4,466 are actively contributing and 3,314 are in receipt of pension benefits. The following chart summarises the trends in membership:



The chart on the previous page demonstrates that although there has been a relatively static position in relation to active contributing membership, there has been a continuing rise in the number of pensioners. Since 2012 the total membership has increased by 1,427 members (a 16% increase overall). During this period the number of pensioners and their dependants has increased by 25%, and the number of active contributing members has increased by 6%. This presents a challenge to the Fund to ensure that it manages its future cash flows effectively as the fund matures. This was included as part of the considerations when undertaking the full investment review.

A full reconciliation of the movement in membership during 2016/17 is included in Note 25 to the Accounts, page 49.

## **Financial Performance**

The Financial Statements for the Fund are set out from page 26.

Key Figures from these are set out below:

	<b>Restated 2015/16 £'000</b>	<b>2016/17 £'000</b>
Net (Withdrawals) from Dealings with Members	<b>(1,971)</b>	<b>(2,229)</b>
Net Return on Investments	<b>2,018</b>	<b>118,278</b>
Net Increase/(decrease) in the Fund during the Year	<b>(3,225)</b>	<b>112,493</b>
Closing Net Assets of the Scheme	<b>541,900</b>	<b>654,393</b>

These highlight two key messages in relation to the Financial Position of the Fund:

- ***Strong financial returns from Fund Managers have resulted in an increase of £112m in Net Assets***
- ***A Net Withdrawal position in relation to dealing with Fund Members***

The strong asset position, along with the 2014 Triennial Valuation of funding levels, demonstrates that the Fund is well placed to meet its future pension and other benefit liabilities.

The slightly increasing net withdrawal position supports the trend that is seen in the membership chart as outlined on page 3.

Recent changes in the legislation around what pensioners are able to do with their pension benefit entitlements have increased individual freedom to withdraw from the Fund potentially triggering significant transfer movements. The fund has not however seen any significant withdrawal from the fund as a result of this legislation but is continuing to monitor this position.

## Governance and Decision Making

Following the significant changes required in the governance arrangements which came into force on 1 April 2015 the Pension Fund Board was established. Joint meetings of the Pension Fund Committee and Pension Fund Board have been held regularly during 2016/17.

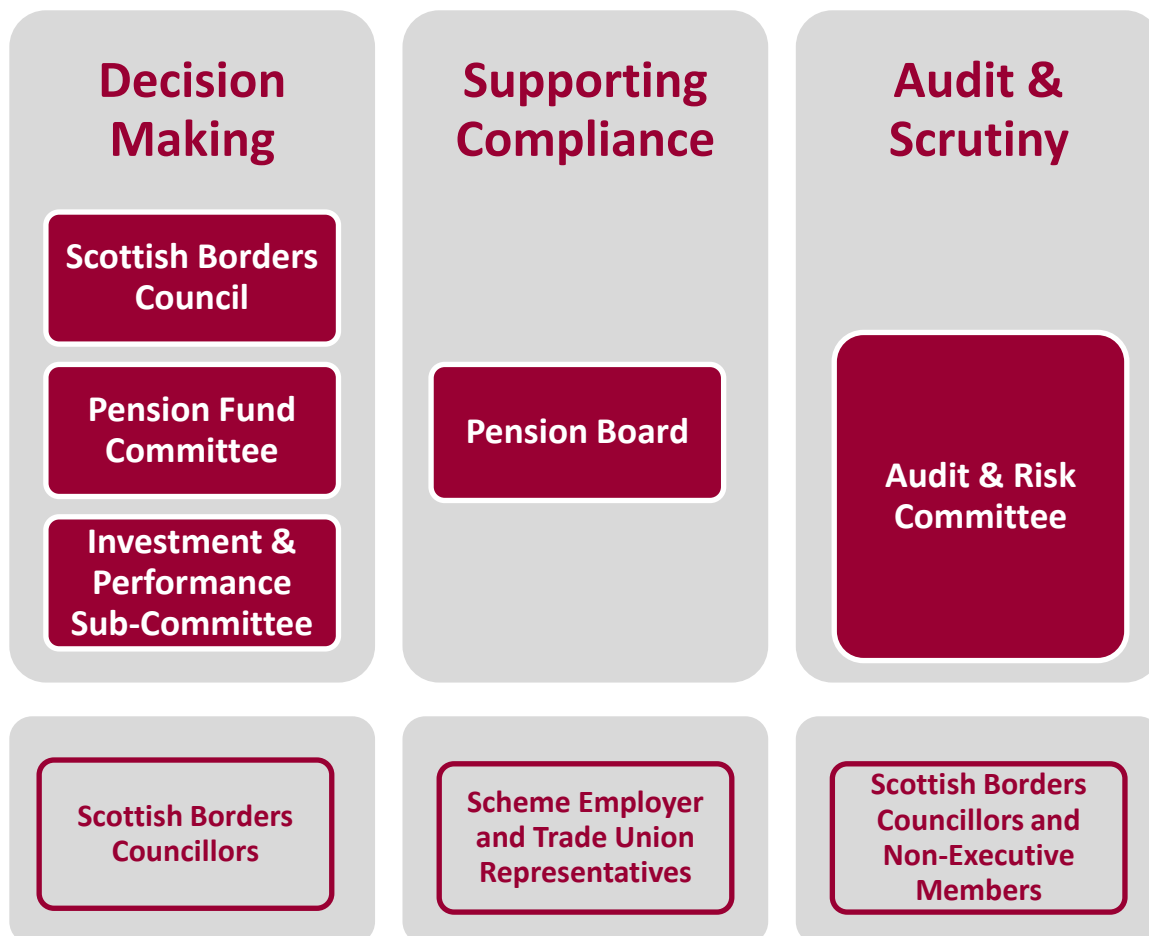
The remit of the Pension Fund Board is to assist the Council (as administering authority) in relation to:

- a) securing compliance with the regulations and other legislation relating to the governance and administration of the Scheme and any statutory pension scheme that is connected with it;
- b) securing compliance with requirements imposed in relation to the Scheme and any connected scheme by the Pensions Regulator; and
- c) such other matters as the regulations may specify.

This body is made up of four scheme employer representatives and four trade union representatives.

The membership of the Pension Fund Committee comprises elected members from the administering authority, Scottish Borders Council.

The governance of the Fund is as follows:



The Annual Governance Statement and Governance Compliance Statement 2017 can be found on pages 17 to 23.

## Knowledge and Skills

The Training Policy for the Fund was updated and agreed on 16 June 2016 reflecting the governance arrangements set out on page 5.

Following the annual training needs assessment, the 2016/17 training programme was developed. It was delivered to all members of both the Pension Fund Committee and the Pension Fund Board and covered the following areas:

- Financial Markets and Investment Products
- Role of Custodian
- General Pension Fund regulatory environment
- LGPS regulatory environment

The Training Policy sets out a target for all members of the Pension Fund Committee and Pension Fund Board in relation to attendance at Committee meetings and training events. The 2016/17 performance is set out below.

<i><b>Pension Fund Committee</b></i>	<b>Number of Members Attending</b>	
<b>% Attendance</b>	<b>Committee (Target – 2 meetings)</b>	<b>Training (Target – 2 sessions)</b>
100% (4 sessions or more)	2	2
75% (3 sessions)	3	3
50% (2 sessions)	1	1
≤ 25% (1 or no sessions)	1	1

<i><b>Pension Fund Board</b></i>	<b>Number of Members Attending</b>	
<b>% Attendance</b>	<b>Committee (Target – 2 meetings)</b>	<b>Training (Target – 2 sessions)</b>
100% (4 sessions or more)	1	3
75% (3 sessions)	4	5
50% (2 sessions)	2	-
≤ 25% (1 or no sessions)	1	-

The Policy also requires members of the Pension Fund Board and Committee to attend at least two meetings per year and two training events. All Members of the Pension Fund Board fully met the training targets set in the Training Policy and 87.5% met the attendance target. 85.7% of the Pension Fund Committee met the training and attendance target.

The Fund is able to demonstrate full compliance with the relevant best practice standards and this is set out in the Governance Compliance Statement from page 19.

## Fund's Aims and Objectives

### Primary Aim of the Fund

- To provide for members' pension and lump sum benefits on their retirement or for their dependants' benefits on death before or after retirement, on a defined benefits basis.

### Funding Objectives

- Set levels of employer contribution that will **build up a fund of assets that will be sufficient to meet all future benefit payments** from the Fund.
- Build up the required assets in such a way that ensure levels of **employer contribution that are stable**

### Pensions Administration

- Deliver a **High Quality Pension Service to Members.**

### Governance

- Ensure that Scottish Borders Pension Fund is **managed effectively, transparently and remains compliant.**

The Fund approved a Business Plan for the period covering 2016/17 – 2018/19 on 16 June 2016 and this presented the action plan associated with supporting the delivery of these aims and objectives. The key following actions were completed during 2016/17.

- ***Full review of Investment Strategy based on asset and liability modelling completed***
- ***Strategic Asset Allocation review completed and new fund managers appointed***
- ***Custodian procurement complete and services transferred successfully to Northern Trust***
- ***2015/16 Annual Report and Financial Statements produced within prescribed timescales with no audit qualifications***

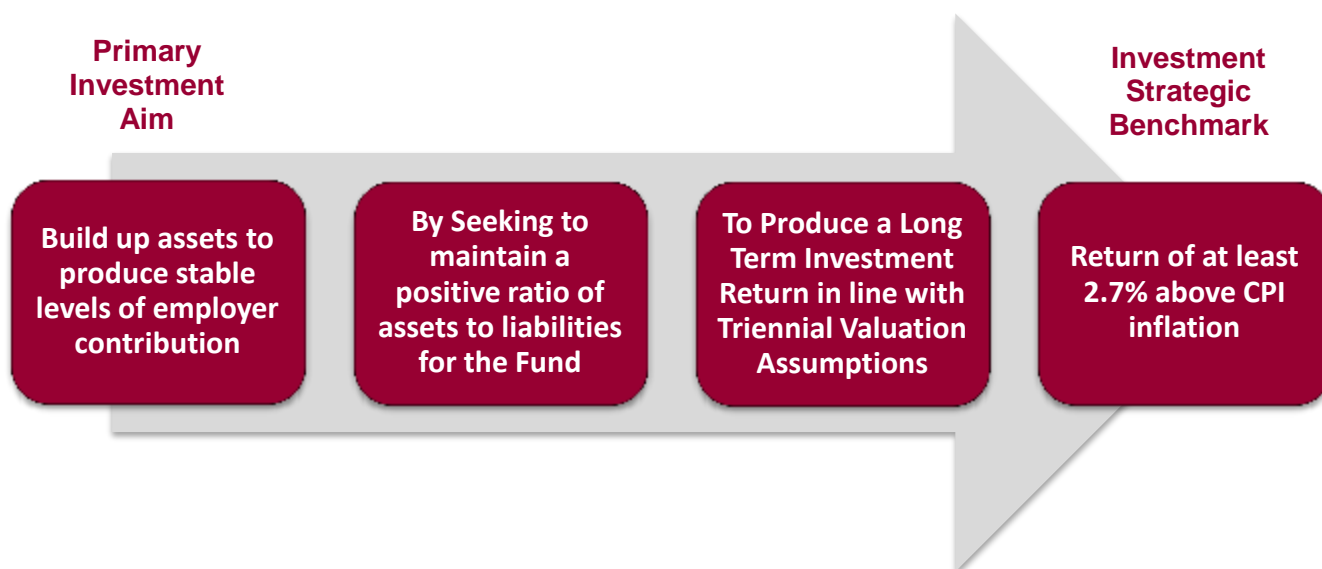
A full copy of the Business Plan can be found at [www.scotborders.gov.uk/pensions](http://www.scotborders.gov.uk/pensions).



## MANAGEMENT COMMENTARY

### Investment Strategy

The Statement of Investment Principles (SIP) approved on the 22 June 2017 sets out the Fund's current Investment Strategy and a copy of this document can be found at: [www.scotborders.gov.uk/pensions](http://www.scotborders.gov.uk/pensions). An extract of the key elements of the SIP are included in Annex 1 and the Investment Strategy is summarised below:



The following table indicates the actual position at 31 March 2017 in relation to asset allocation versus the revised benchmark which was agreed as part of the Investment Strategy:

Asset Class	Asset Allocation at 31/3/16 %	Asset Allocation at 31/3/17 %	Strategic Benchmark %
UK Equity	18.8	18.2	14.0
Global Equity	46.8	49.8	33.5
Bonds	10.8	9.7	15.0
Alternatives	17.0	16.9	22.5
Property	6.1	5.1	15.0
Cash	0.5	0.3	0.0
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

As can be seen from the table on the above there has not been any major changes in the position of the allocation of assets between 2015/16 and 2016/17. The Fund has taken a deliberate decision to run underweight in the Bonds allocation due to the current market conditions. A revised asset allocation was agreed in December 2016 with greater focus on index linked assets including long leased property, with some initial reallocation of fund taking place before 31 March and it is anticipated the required transfers will be implemented during 2017/18 due to the nature of the new investment areas.

The strategic benchmark represents the asset allocation split as approved in December 2016 and contained with the 2017 Statement of Investment Principles.

## MANAGEMENT COMMENTARY

### Review of Investment Performance

#### 2016/17 in Numbers

- **Strong 3 year annualised investment performance of 10.9%, 0.9% above benchmark**

- **Strong 1 year performance** to March 2017 with investment returns of 21.5% in the year to a benchmark of 19.5%

#### Key Successes 2016/17

### Investment Markets

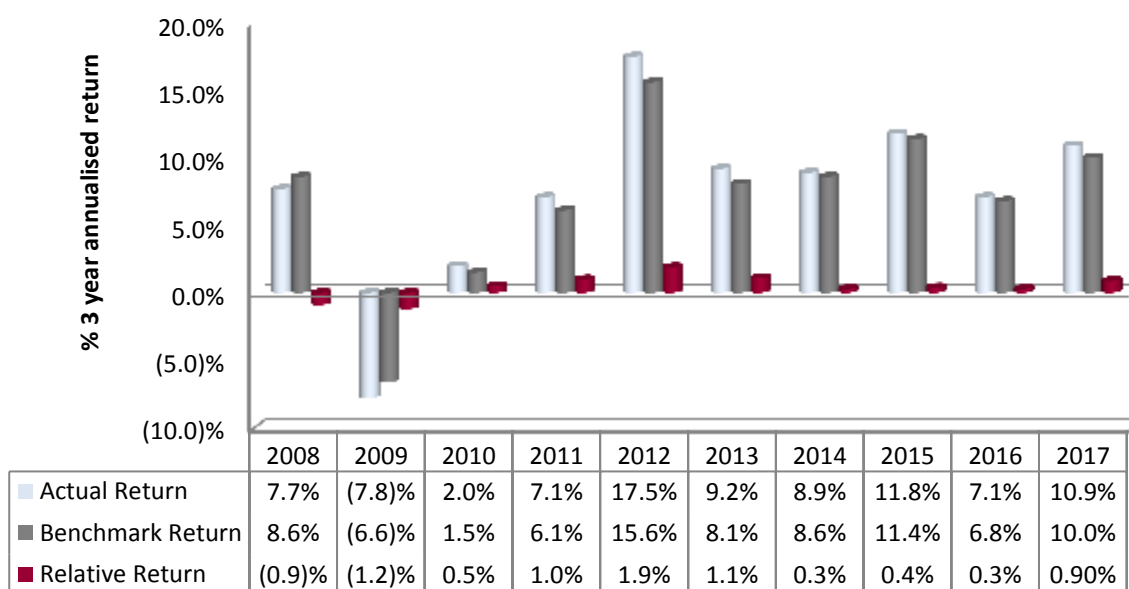
During 2016/17 there was an unprecedented level of volatility across a number of markets due largely to global political events. Over the 1 year rolling period a positive return was experienced in Equities both UK and Global. The 3 year rolling period is still positive compared to its benchmark, although lower due to the lower than benchmark returns during 2015/16. The factors affecting the markets were:

- Election of new US administration with promise of fiscal stimulus led to strong “risk on” environment as global equities rallied from 2015/16 levels.
- Uncertainty around BREXIT resulted in an element of volatility during the year but following the outcome markets have remained positive..
- Corporate bonds performed positively amidst a backdrop of improving global economic growth.

## Investment Performance

The Fund's performance against benchmark over the past 10 years is highlighted in the chart below. This chart demonstrates that the rolling 3 year annualised relative return (i.e. Fund's return achieved compared with the benchmark) since 2010 has been positive, and that over the 10 year period there has only been one year of negative returns overall for the Fund and that was during the financial crisis.

### 3 Year Annualised Returns ending 31 March



Including the impact of the passive currency hedge, the overall fund return over 3 years was 10.9% p.a. versus the benchmark of 10.0% p.a., and the Fund return over 1 year was 21.5% p.a. compared to a benchmark of 19.5% p.a. Excluding the impact of the currency hedge, the fund return over 3 years was 11.9% p.a. versus the benchmark of 11.3% p.a. and the fund return over 1 year was 22.9% p.a. versus the benchmark of 20.9% p.a.

The Fund achieved these favourable returns in 2016/17 despite the volatile period in the markets during the year. The fluctuations in currency and the resulting currency hedge payments pulled the overall performance of the fund down by 1.4% during the year and 1% over the 3 year period. The currency hedge was fully removed from the fund in December 2016.

Each quarter the Investment Consultants, KPMG, reported on the Fund's quarterly performance by individual investment manager and mandate to the Joint Pension Fund Committee, and Pension Board. The Investment and Performance Sub Committee also met each Manager twice during the year giving members an opportunity to gain a deeper understanding of the investments, the decision making process and their performance.

The following table provides an analysis of how the Fund's investments performed against the Funds Benchmark.

Return on Investment as at 31/3/2017	1 year rolling return		3 year rolling return	
	Fund %	Bench <sup>1</sup> %	Fund %	Bench <sup>1</sup> %
<b>Total Fund including Currency Hedging</b>	<b>21.5</b>	<b>19.5</b>	<b>10.9</b>	<b>10.0</b>
<b>Total Fund excluding Currency Hedging</b>	<b>22.9</b>	<b>20.9</b>	<b>11.9</b>	<b>11.3</b>
Global Equities including UK	31.0	29.6	<b>16.6</b>	15.4
UK Equities	22.0	22.0	<b>7.9</b>	7.7
UK Government Bonds	6.6	6.6	<b>11.6</b>	10.5
UK Corporate Bonds	11.8	9.2	<b>7.8</b>	7.4
Pooled Bonds	6.9	3.3	<b>n/a</b>	n/a
Property	1.9	3.7	<b>10.0</b>	10.2
Alternatives	7.5	4.5	<b>5.4</b>	4.5
Cash				

**Key:**

<sup>1</sup> **Bench:** Benchmark Return which reflects the overall performance of the individual markets available to the manager within the mandate given to them.

The performance of the Fund overall has exceeded the rolling 1 year and 3 year benchmark. The rolling 1 year performance was aided by strong performance from Harris Associates in global equities, off-setting an under performance from Morgan Stanley in global equities and UBS Property portfolios.

**Top 20 Direct Equity Holdings at 31 March 2017**

Company	Market Value of Holding £ m	Company	Market Value of Holding £ m
Prudential	6.8	Glencore	3.4
Amazon	6.7	Allianz SE	3.3
Royal Caribbean Cruises	5.2	Richemont	3.3
Naspers	4.6	CNH Industrial	3.3
Taiwan Semicon.SPN.ADR.1:5	4.2	Anthem Inc	3.2
SAP	4.0	Credit Suisse	3.2
Moodys Corp	3.9	Daimler	3.1
ADR Baidu	3.5	CRH PLC	3.0
Alphabet Inc	3.5	AIA Group	2.9
BNP Paribas	3.4	Samsung Electronic	2.8

## MANAGEMENT COMMENTARY

### Funding Position

#### 2014 Valuation

- 101 % Funding Level for the Fund
- Stable Common Employer Contribution Rates at 18%

#### Triennial Valuation 2014

The Triennial Funding Valuation as at the March 2014 was undertaken during 2014/15 and the final certified report was presented to the joint meeting of the Pension Fund Committee and Pension Board on 18 June 2015. A copy of the report is available via the Council's committee papers website <http://scottishborders.moderngov.co.uk/>.

The outcome of the 2014 Valuation was a funding level of 101% and a Fund which is no longer in a funding deficit position. As a result there was no change in the overall Fund common employer contribution rate, although some individual employer rates did change for specific circumstances.

Valuation Date as at 31 March	Past Service Funding Position – Scottish Borders Council Pension Fund		
	2008 £m	2011 £m	2014 £m
Value of the Scheme Liabilities	(310.1)	(402.2)	(487.6)
Smoothed Asset Value	299.2	384.8	490.5
<b>Surplus/ (Deficit)</b>	<b>(10.9)</b>	<b>(17.4)</b>	<b>2.9</b>
<b>Funding Level</b>	<b>96%</b>	<b>96%</b>	<b>101%</b>

Note 26 to the Statement of Accounts on page 47, contains details of the outcome and assumptions used in the 2014 Valuation and the impact that it had on employer contribution rates.

This is the first valuation that has taken into account the move to an LGPS based on career average earnings rather than final salary which came into effect on 1 April 2015.

A major contributing factor to the improvement in the funding level has been the strong investment performance that the Fund has achieved over the past 3 years.

#### Valuation for Statutory Accounts at 31 March 2017

Note 27 to the Statement of Accounts on page 48, contains the actuarial present value valuation for the Fund as required by the International Accounting Standard (IAS) 26. This shows a net liability for the Fund of £254.2m. However the liabilities for this figure are calculated on an IAS 19 basis and therefore will differ from the results of the 2014 Triennial Funding Valuation because IAS 19 stipulates a specific discount rate to enable comparability rather than a rate that reflects the market rate for investment returns on the Fund's assets. It is therefore not appropriate to use this as a measure for setting employer contribution rates or assessing the overall long term funding health of the fund. The full version of the actuary report and the current Funding Strategy is available via the Councils website: [www.scotborders.gov.uk/pensions](http://www.scotborders.gov.uk/pensions)

## MANAGEMENT COMMENTARY

### Pensions Administration Update

#### 2016/17 in Numbers

- 18 Scheme Employers
- £21.7m of Pension and Other Benefits paid during year
- £19.4m of Contributions Received from 4,466 Active Members and their Employers
- 6,515 Benefits Statements issued

- All Annual Benefit Statements issued by deadline, incorporating the new CARE benefits
- Testing of Business World for processing Pension payments achieved in advance of 1st April 2017 implementation
- Successful admission of additional Bodies to the Fund

#### Key Successes 2016/17

### Scheme Employer Liaison

The Scheme Employer Liaison meeting was held during 2016/17 and covered the requirements for the year end returns, requirements for the triennial valuation and an overview of investments. The opportunity was also taken to reinforce the scheme changes and the impact of these for the Fund and employers.

The good relationship with the main Scheme Employers also has resulted in the continued involvement of 4 employers as representatives in the new Pension Board.

### MEMBERSHIP

Membership of the LGPS is voluntary and employees are free to choose whether to join the scheme, remain in the scheme or make their own personal arrangements outside the scheme.

Teachers are not included as they come within other national pension schemes. There are 18 employer organisations within the Fund including the Council itself and membership by employer is analysed over the page.

Membership Details as at 31 March 2017	Number of Contributors	Pensioners	Deferred Pensioners	Total
<b>Scheduled Bodies:</b>				
Scottish Borders Council	3,246	3,067	2,344	8,657
Borders College	182	66	96	344
Visit Scotland (Scottish Borders)	1	6	9	16
	<b>3,429</b>	<b>3,139</b>	<b>2,449</b>	<b>9,017</b>
<b>Active Admitted Bodies:</b>				
Scottish Borders Housing Association	100	84	67	251
LIVE Borders	209	16	29	254
SBCares	673	43	89	805
Jedburgh Leisure Facilities Trust	2		2	4
L&B Community Justice Authority	2	1	5	8
Amey Community Limited	6	5	3	14
CGI	45			45
	<b>1,037</b>	<b>149</b>	<b>195</b>	<b>1,381</b>
<b>Admitted Bodies with No Active Contributing Members:</b>				
Gala Youth Project		1	1	2
Scottish Borders Careers		1	3	4
Others		24	4	28
	<b>0</b>	<b>26</b>	<b>8</b>	<b>34</b>
<b>Total</b>	<b>4,466</b>	<b>3,314</b>	<b>2,652</b>	<b>10,432</b>

## Member Engagement

This has been identified as an area for development within the Pension Fund Business Plan 2016/17 – 2018/19. The development of a Communication Policy and associated action plan is included as an action for delivery within the next three year period. This will include exploiting the use of the web to engage with members via self-service interaction with the new pension administration system and improved information being available on the website.

Trade Unions as member representatives have also shown good engagement through their attendance at the Pension Fund Committee and also by securing 4 representatives for the Pension Board and identifying several substitutes.

## Pensions Administration Strategy

The Fund's Pensions Administration Strategy was approved in September 2015. This sets out scheme employer and administering authority roles and responsibilities and defines the service performance standards.

### How have we done?

A comprehensive report on Pensions Administration performance for 2016/17 was presented to the joint meeting of the Pension Fund Committee and Pension Board on 22 June 2017 and a copy of the report is available via the Council's committee papers website <http://scottishborders.moderngov.co.uk/>.

## Administering Authority Performance Measures

Many of the performance standards have been met in 2016/17 and are comparable with the positive performance in the previous year. During 2015/16 the target performance days for responding to general queries was reduced from 10 to 5 days and 100% of queries were replied to within this new target.

### Service Standard - Estimates

Standard	Volume of Requests	Target Response	2016/17 % on Target
Estimates – Transfer In	80	20 Days	21.25%
Estimates – Transfer Out	59	20 Days	25.42%
Estimate – All Other	875	10 Days	90.40%
<b>Total Estimates</b>	<b>1,014</b>		

### Service Standard – Query Response Turnaround

Standard	2015/16		2016/17	
	Volume of Queries	% on Target	Volume of Queries	% on Target
Query responses – within 5 working days	1,075	100%	972	100%
Benefit Statement queries – within 20 working days	55	100%	78	46%
<b>Total</b>	<b>1,130</b>		<b>1,050</b>	

### Service Standard - Other

Area	Measure	Completed
Employer Liaison Meetings	1 per annum	Yes
Benefit Statements	by end of August	Yes

There was a reduction in performance with meeting the 20 day target for responding to the Annual Benefit Statement queries, however, this was as a result of the growing complexity of queries with them now covering up to three sets of scheme benefits.

The main area that continues to be behind target is in relation to Transfers. However, all Scottish Pension Funds will have suffered delays with the transfer process this year, due to legislative changes (change to CARE scheme, “discount rate” announced in the budget), and the resultant change in methodology to calculate transfer values. The issue of GAD (Government Actuaries Department) guidance and translation into pension administration software has delayed the turnaround of transfer requests.



## Employer Performance Measures

### Service Standard – Employer Notifications

Standard	Volume of Notifications	Target %	% Achieved
New starts notification - within 20 working days	530	90%	100%
Changes notified – within 20 working days	571	90%	100%
Retirement info – at least 20 working days before	206	90%	100%
Early leaver notification – within 20 working days	544	90%	100%
Death in service notification – within 10 working days	3	90%	100%

### Service Standard – Pension Contribution Payments

The following tables compare the date contribution payments are received against the target date for each of the Scheduled and Active Admitted Bodies.

Employer Body	Number of Monthly Payments Received		
	By Target Date (19 <sup>th</sup> of Month)	Late	% On Time
Scottish Borders Council	12	-	100%
Visit Scotland	12	-	100%
Borders College	12	-	100%
Scottish Borders Housing Association	12	-	100%
Jedburgh Leisure Facilities Trust	10	2	83%
LIVE Borders	6	6	50%
AMEY Community Limited	12	-	100%
SBCares	12	-	100%
CGI	6	-	100%

During 2016/17 there was an increase in the number of payments being received late when compared to 2015/16. Due to the repeat nature of late payments made by Live Borders they were written to and reminded of their responsibility to make payment on time. The payments dates continue to be monitored on a monthly basis.

**Councillor David Parker**  
Chairman  
Pension Fund Committee

**Tracey Logan**  
Chief Executive  
Scottish Borders Council

**David Robertson**  
Chief Financial Officer  
Scottish Borders Council

28 September 2017

## GOVERNANCE

### Annual Governance Statement 2016/17

#### Introduction

The Local Government Pension Scheme (Scotland) Regulations 2014 require Administering Authorities to measure their governance arrangements set out against standards set by Scottish Ministers. These standards are established via a number of best practice principles.

The key document summarising the governance arrangements for the Pension Fund is the Governance Policy and Compliance Statement (as amended on 18 June 2015) which is available on the website [www.scotborders.gov.uk/pensions](http://www.scotborders.gov.uk/pensions).

#### The Governance Framework

The key elements of the Pension Fund's governance arrangements include:

- a) Scottish Borders Council is the Administering Authority for the Local Government Pension Scheme set up for the Scottish Borders geographic area.
- b) The Council has delegated its responsibilities as Scheme Manager to the Pension Fund Committee. The members of the Committee act as quasi-trustees and oversee the management of the Scottish Borders Council Pension Fund.
- c) The introduction of the Pensions Board, which meets jointly with the Committee, formalises the involvement of the employers and trade unions representing the membership. All members of the Committee and Board are covered equally by the Training Policy to give them full opportunity to contribute effectively.
- d) The approval of the Pension Fund Business Plan covering the period 2016/17 – 2018/19 to improve planning and monitoring of the performance of the Fund and to demonstrate the "Myners Principle" relating to effective decision making. The business plan supports the delivery of the objectives of the Fund which are to deliver a high quality pension service to members that was managed effectively, transparently and was compliant.
- e) The Pension Fund appoints professional advisers and external service providers, covering investment advisory, custodian and actuarial services.
- f) The system of internal financial control operates within a financial strategy and is based on a framework of delegation and accountability for officers and elected members embodied in procedural standing orders, financial regulations, scheme of delegation, scheme of administration, supported by a framework of administrative procedures including the segregation of duties, and regular financial management information. In particular, the system includes comprehensive accounting systems that record income and expenditure for both member and investment activities, regular reviews of investment reports that measure investment returns against agreed benchmarks, regular reviews of investment manager reports that measure performance against agreed targets, and independent performance reviews of the Fund by the Fund's investment consultant and performance monitoring services provider.
- g) The Pension Fund follows the Council's approach to risk management and assesses risk using a scoring methodology and subjects the risk register to regular review.
- h) The Chief Financial Officer (Section 95 officer) for the Council is responsible for ensuring the proper administration of the financial affairs of the Pension Fund. This includes ensuring appropriate professional advice is sought and is given to the Pension Fund on all financial matters, keeping proper financial records and accounts, and maintaining an effective system of internal financial control.

- i) The Chief Officer HR for the Council is responsible for the pension benefit policy oversight and day-to-day administration of member benefits in accordance with statutory legislation and the approved pensions' administration strategy.
- j) The Chief Officer Audit & Risk (Head of Internal Audit) provides an independent and objective annual opinion on the effectiveness of internal control, risk management and governance based on the delivery of an approved plan of systematic and continuous internal audit review in conformance with the Public Sector Internal Audit Standards.
- k) The Pension Fund responds to findings and recommendations of external audit and internal audit, as appropriate. The Audit and Risk Committee is integral to overseeing independent and objective assurance and monitoring improvements in internal control and governance.

### **Review of Framework**

The Council as Administering Authority of the Pension Fund conducts an annual review of the effectiveness of its overall governance framework which is presented to the Audit and Risk Committee whose role includes high level oversight of the Pension Fund's governance, risk management, and internal control arrangements.

The review is informed by the work of an officer assessment of the Fund's compliance with the best practice principles and the detail of this is set out in the Governance Compliance Statement 2016/17, Annex 1 (pages 19 – 23).

The review of the effectiveness of the system of internal financial control is informed by the work of professional accountancy staff within the Council, the assurances from the Chief Officer Audit & Risk's annual internal audit opinion and report on the work of internal audit, and by the external auditors' reports.

The review cycle for the risk register is undertaken in line with agreed practice and the current status is summarised in the Risk Management Statement.

The conclusion from the review activity outlined above is that in 2016/17 the Pension Fund continued to demonstrate that the governance arrangements and framework within which it operates are sound and effective.

### **Improvement Areas of Governance**

The review has identified some areas where further improvements can be made to enhance the existing governance arrangements:

- a) Development of a communications plan to improve awareness and understanding of stakeholders and encourage maximum membership of the Fund.
- b) Continue to monitor the implications of new national policy on freedom of choice of pension sums.

### **Certification**

It is our opinion that reasonable assurance can be placed upon the adequacy and effectiveness of Scottish Borders Council Pension Fund's systems of internal control and governance. Although areas for further improvement have been identified the annual review demonstrates sufficient evidence that the Pension Fund's Governance Policy is operating effectively and that the Pension Fund fully complies with the best practice principles as demonstrated in the Governance Compliance Statement, Annex 1 (pages 19 – 23).

**Councillor David Parker**  
**Chairman**  
**Pension Fund Committee**  
**28 September 2017**

**Tracey Logan**  
**Chief Executive**  
**Scottish Borders Council**

## GOVERNANCE

### Governance Compliance Statement 2016/17

The Local Government Pension Scheme (Scotland) Regulations 2014 require Administering Authorities to measure their governance arrangements set out against standards set by Scottish Ministers. These standards are established via number of best practice principles. The following table contains an assessment of the Fund's compliance with these principles and reflects the changes following the introduction of the Pension Board.

Principle		Full Compliance	Comments
<b>Structure</b>			
A	The management of the administration of benefits and strategic management of Fund assets clearly rests with the main committee established by the appointing council.	Yes	<p>Scottish Borders Council acts as administering authority for the Pension Fund and delegates its responsibilities as Scheme Manager to the <b>Pension Fund Committee</b> (the Committee).</p> <p>The Committee comprises of 7 elected members.</p> <p>The Council's Scheme of Administration sets out the Committee's remit.</p>
B	Representatives of participating LGPS employers, admitted bodies and scheme members (including pensioner and deferred members) are members of either the main or secondary committee established to underpin the work of the main committee	Yes	<p>The <b>Pensions Board</b> (the Board) formalises the involvement of the employers and trade unions representing the membership.</p> <p>The Fund's Board has 8 members, 4 employer representatives and 4 trade union representatives covering all pension fund members.</p> <p>The Board constitution is in line with the regulations, a copy of which is included in the Fund's Governance Policy and Compliance Statement.</p> <p>The Board meets jointly with the Committee and the Board Constitution and the Scheme of Administration set out how disputes between the two bodies should be resolved.</p> <p>The <b>Investment and Performance Sub-Committee</b> (the Sub-Committee) established under the Committee has its remit set out in the Scheme of Administration. The Membership of the Sub-Committee is comprised of the 7 elected members from the Committee and 2 (non-voting) members from the Board.</p>

Principle		Full Compliance	Comments
C	Where a secondary committee or panel has been established, the structure ensures effective communication across both levels.	Yes	Minutes of the Sub-Committee and any other Sub-Groups are submitted to Committee for approval.  2 members from the Board and all members of the Committee are part of the Sub-Committee which has a remit to monitor investment performance.
D	Where a secondary committee or panel has been established, at least one seat of the main committee is allocated for a member from the secondary committee or panel.	Yes	The Scheme of Administration states that any Sub-Group established will have member(s) of the Committee as part of its membership.
<b>Committee Membership and Representation</b>			
A	All key stakeholders are afforded the opportunity to be represented within the main or secondary committee structure. These include: (i) employing authorities (including non-scheme employers, e.g. admitted bodies) (ii) scheme members (including deferred and pensioner scheme members), (iii) where appropriate, independent professional observers, and (iv) expert advisors (on an ad-hoc basis)	Yes	The Board and Committee meet jointly ensuring employer and member (trade union) representation at meetings.  The Investment Sub-Committee has two non-voting members from the Board.  The Independent Investment Consultant and key Finance and HR Officers also attend in an advisory capacity.
B	Where lay members sit on a main or secondary committee, they are treated equally in terms of access to papers and meetings, training and are given full opportunity to contribute to the decision making process, with or without voting rights.	Yes	All members of the Committee and Board are covered equally by the Training Policy (as amended annually in June).  The Board was established by Council on 2 April 2015. The Scheme of Administration for the Committee and Board Constitution provides for the joint meetings with equal rights to receive papers and access meetings in the same way.

Principle		Full Compliance	Comments
<b>Selection and role of lay members</b>			
A	That committee or panel members are made fully aware of the status, role and function they are required to perform on either a main or secondary committee.	Yes	For elected members this is part of Council's Code of Governance along with Member induction programme.  In addition the Fund's Training Policy provides for an annual training needs assessment, and an annual programme of training to be made available to all members of the Committee and Board.
B	At the start of any meeting, committee members are invited to declare any financial or pecuniary interest related to specific matters on the agenda.	Yes	Part of Council's Code of Governance requires the declaration of members' interests as a standard agenda item on all committees.
<b>Voting</b>			
A	The policy of individual administering authorities on voting rights is clear and transparent, including justification for not extending voting rights to each body or group represented on main LGPS committees.	Yes	This is set out in the Council's Scheme of Administration and the Board's Constitution.
<b>Training/Facility time/Expenses</b>			
A	In relation to the way in which statutory and related decisions are taken by the administering authority, there is a clear policy on training, facility time and reimbursement of expenses in respect of members involved in the decision-making process.	Yes	The Members Expenses are managed under the Council's policies. The Training Policy also covers the reimbursement of Training Related Expenses.
B	Where such a policy exists, it applies equally to all members of committees, sub-committees, advisory panels or any other form of secondary forum.	Yes	Training policy for all members of Pension Fund Board and Committee approved by Board and Committee annually in June.

Principle		Full Compliance	Comments
C	The Administering Authority considers the adoption of annual training plans for committee members and maintains a log of all such training undertaken.	Yes	Annual Training Plan produced and logs of training are being maintained.
<b>Meetings (frequency/quorum)</b>			
A	An administering authority's main committee or committees meet at least quarterly.	Yes	The joint meetings of the Committee and Board are quarterly.
B	An administering authority's secondary committee or panel meet at least twice a year and is synchronised with dates when the main committee sits.	Yes	Investment Sub-Committee meets every six months in between main joint Committee/Board meetings.
C	An administering authority that does not include lay members in their formal governance arrangements must provide a forum outside of those arrangements by which the interests of key stakeholders can be represented.	Not applicable	Pension Board formally provides for the stakeholders engagement.
<b>Access</b>			
A	Subject to any rules in the Council's constitution, all members of main and secondary committees or panels have equal access to committee papers, documents and advice that falls to be considered at meetings of the main committee.	Yes	Papers sent to all Committee/Board members detailed in Scheme of Administration.

<b>Principle</b>		<b>Full Compliance</b>	<b>Comments</b>
<b>Scope</b>			
A	Administering authorities have taken steps to bring wider scheme issues within the scope of their governance arrangements.	Yes	The Scheme of Administration sets out that the Committee as having a remit which covers all matters relating the Council's role as the Administering Authority for the Scottish Borders Council Pension Fund, within the terms of all relevant Local Government Pension Scheme legislation and the requirements of the Pension Regulator.
<b>Publicity</b>			
A	Administering authorities have published details of their governance arrangements in such a way that stakeholders, with an interest in the way in which the scheme is governed, can express an interest in wanting to be part of those arrangements.	Yes	Minutes and Public papers available via Council website, as are various governance and scheme policy documents.



## GOVERNANCE

### Risk Management Statement

The Fund is committed to a strong control environment to ensure that risks are identified, understood, managed and monitored appropriately.

The Risk Register for the Pension Fund has been developed in line with the Council's approach to risk management and assesses risk using a scoring methodology based on likelihood and impact.

A full risk review was undertaken in June 2016 and subsequent reviews have followed the Council's cycle, as shown below:

Level of risk (Inherent risk score)	Reporting and Review Cycle
<b>RED -Very High (15-25)</b>	3 monthly reviews of action progress throughout the year
<b>AMBER – High (6-12)</b>	6 monthly review
<b>GREEN – Low (1-5)</b>	Annual review

The headings under which the Council consider risk are set out below and the analysis of the level and number of risks are set out below:

Risk Category	Risk Assessment					
	Before Controls			After Controls		
	Red	Amber	Green	Red	Amber	Green
Asset & Investment	3	6	-	-	7	2
Employer	-	4	-	-	3	1
Resource & Skill	-	5	-	-	3	2
Liquidity	2	4	-	1	4	1
Administrative	-	8	-	-	3	5
Regulatory & Compliance	1	3	-	1	1	2
Reputation	1	4	-	-	2	3
<b>Total Number of Risks</b>	<b>7</b>	<b>34</b>	<b>-</b>	<b>2</b>	<b>23</b>	<b>16</b>

The two risks that remain at red assessment i.e. high risk as at 31 March 2017 are:

- ***Change in the composition of the Pension Fund Membership between active/deferred/pensioners***
- ***Legislation Changes impacting on the Fund***

## STATEMENT OF RESPONSIBILITIES FOR THE STATEMENT OF ACCOUNTS

### The Council's responsibilities

The Council is required to:

- Make arrangements for the proper administration of the financial affairs of the Scottish Borders Council Pension Fund (the Fund) and to secure that one of its officers has the responsibility for the administration of those affairs. In this Council, that officer is the Chief Financial Officer.
- Manage the affairs of the Fund to secure economic, efficient and effective use of resources and safeguard its assets
- Approve the Statement of Accounts of the Fund (in Scotland, the audited accounts must be laid before a meeting of the Authority within two months of receipt of the audit certificate)

### The Chief Financial Officer's responsibilities

The Chief Financial Officer is responsible for the preparation of the Statement of Accounts in accordance with the Local Government Pension Scheme (Administration) (Scotland) Regulations 2014, as updated by the Local Government Pension Scheme Amendment (Scotland) Regulations 2010 (SSI 2010/234) and supporting guidance issued by the Scottish Government.

In preparing this Statement of Accounts, the Chief Financial Officer has:

- Selected suitable accounting policies and then applied them consistently
- Made judgements and estimates that were reasonable and prudent
- Complied with the Code of Practice on Local Authority Accounting

The Chief Financial Officer has also:

- Kept proper accounting records which were up to date
- Taken reasonable steps for the prevention and detection of fraud and other irregularities

### Statement of Accounts

The Statement of Accounts presents a true and fair view of the financial position of the Scottish Borders Council Pension Fund as at 31 March 2017, and of its income and expenditure for the year ended 31 March 2017.

**Councillor David Parker**  
Chairman  
Pension Fund Committee

**David Robertson (CPFA)**  
Chief Financial Officer  
Scottish Borders Council

**28 September 2017**

## STATEMENT OF ACCOUNTS 2016/17 FUND ACCOUNT

Restated 2015/16 £'000		2016/17 £'000	Notes
	<b>Dealings with members, employers and others directly involved in the scheme:</b>		
18,642	Contributions	18,373	8
411	Transfers in from other pension funds	1,074	9
<b>19,053</b>		<b>19,447</b>	
(20,357)	Benefits	(19,986)	10,11
(667)	Payments To And On Account Of Leavers	(1,690)	12
<b>(21,024)</b>		<b>(21,676)</b>	
<b>(1,971)</b>	<b>Net Additions/(Withdrawals) from Dealings with Members</b>	<b>(2,229)</b>	
<b>(3,272)</b>	<b>Management expenses</b>	<b>(3,555)</b>	13
	<b>Return on Investments:</b>		
6,451	Investment Income	8,292	14
(4,282)	Profits and (Losses) on Disposal of Investments and Changes in the Market Value of Investments	110,098	15
(151)	Taxes on Income	(113)	
<b>2,018</b>	<b>Net Return on Investments</b>	<b>118,277</b>	
<b>(3,225)</b>	<b>Net Increase/(Decrease) in the Fund during the Year</b>	<b>112,493</b>	
545,125	Opening Net Assets of the Scheme	541,900	
<b>541,900</b>	<b>Closing Net Assets of the Scheme</b>	<b>654,393</b>	

## NET ASSETS STATEMENT as at 31 March 2017

Restated 2016 £'000		2017 £'000	Notes
	<b>Investment Assets</b>		
203,952	Equities	257,512	17
	<b>Managed Funds:</b>		
32,546	Property	32,169	
82,947	Global Equities	105,284	
62,415	UK Equities- Passive	74,744	
18,643	Bonds	20,379	
39,913	Diversified Fixed Income	42,814	
92,526	Alternatives	110,322	
1,674	Open Ended Investment Contracts	1,825	
1,447	Derivatives – Forward Foreign Exchange	-	
5,715	Cash Deposits	8,158	
<b>541,778</b>	<b>Total Investment Assets</b>	<b>653,207</b>	
926	Other Investment Balances	1,355	
	<b>Current Assets &amp; Liabilities</b>		
1,365	Cash Balances	1,507	
210	Contributions due from Employers	251	
387	Other Current Assets	172	21
(2,766)	Other Current Liabilities	(2,099)	22
<b>122</b>		<b>1,186</b>	
<b>541,900</b>	<b>Net Assets</b>	<b>654,393</b>	

The Fund Account and Net Assets Statement do not show any liability to pay pensions or other benefits in the future. The liability to pay pensions is detailed in the Actuarial Statement in Note 21.

The unaudited accounts were issued on 28 June 2017 and the audited accounts were authorised for issue on 28 September 2017.

David Robertson CPFA  
Chief Financial Officer  
28 September 2017

## NOTES TO THE STATEMENT OF ACCOUNTS

### 1 DESCRIPTION OF THE FUND

#### A) GENERAL

The Scottish Borders Council Pension Fund (the Fund) is part of the Local Government Pension Scheme (LGPS) and is administered by Scottish Borders Council.

The LGPS scheme is governed by the Public Service Pensions Act 2013. The fund is administered by the Council in accordance with the following secondary legislation:

- The Local Government Pension Scheme (Scotland) Regulations 2014 (as amended)
- The Local Government Pension Scheme (Transitional Provisions and Savings) (Scotland) Regulations 2014
- The Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010
- The Local Government Pension Scheme (Governance)(Scotland) Regulations 2015

It is a contributory defined benefit pension scheme administered by Scottish Borders Council to provide pensions and other benefits for pensionable employees of Scottish Borders Council and a range of other scheduled and admitted bodies within the Scottish Borders area.

Organisations participating in the Fund include:

- Scheduled Bodies – which are local authorities and similar bodies whose staff are automatically entitled to be members of the Fund
- Admitted Bodies – which are other organisations that participate in the Fund under an admission agreement between the Fund and the relevant organisation.

#### B) FUNDING

Pensions and other benefits are funded by contributions from employees, employers and investment earnings.

The Pension Fund is subject to a triennial valuation by an independent, qualified Actuary, whose report indicates the required future employer's contributions, which for 2016/17 were based on the valuation undertaken as at the 31 March 2014 as amended by specific changes agreed by the Committee relating to an individual employer. The overall contribution rate was 18% for the Fund as a whole; however employer contribution rates during 2016/17 ranged from 15.5% to 19.0%.

Contributions from active members of the Fund are paid on a tiered basis, the contribution rate being determined by the amount of salary falling into each earnings tier. These rates are made in accordance with the 2008 Regulations and ranged from 5.5% to 12.0% of pensionable pay for the financial year ending 31 March 2017. *From 1 April 2015 these contributions will be based on the LGPS Regulations 2014 in line with the updated LGPS Scheme.*

## C) BENEFITS

Prior to 1 April 2015, pension benefits under the LGPS have been based on final pensionable pay and length of pensionable service as summarised below:

	Service before 1 April 2009	Service after 31 March 2009 until 31 March 2016
<b>Pension</b>	Each year worked is worth 1/80 <sup>th</sup> x final pensionable salary	Each year worked is worth 1/60 <sup>th</sup> x final pensionable salary
<b>Lump Sum</b>	Automatic lump sum of 3 x salary. In addition, part of the annual pension can be exchanged for a one-off tax-free cash payment. A lump sum of £12 is paid for each £1 of pension given up.	No automatic lump sum. Part of the annual pension can be exchanged for a one-off tax-free cash payment. A one off payment of £12 is paid for each £1 of pension given up.

From the 1 April 2015, the scheme will become a career average scheme, whereby members accrue benefits based on their pensionable pay in that year at an accrual rate of 1/49<sup>th</sup>. Accrued pension is uprated annually in line with the Consumer Price Index.

There are a range of other benefits provided under the scheme including early retirement, disability pensions and death benefits.

## 2 BASIS OF PREPARATION OF THE FINANCIAL STATEMENTS

The financial statements summarise the Fund's transactions for the 2016/17 financial year and its position as at the 31 March 2017. The accounts have been prepared in accordance with the *Code of Practice on Local Authority Accounting in the United Kingdom 2016/17* (the Code) which is based upon International Financial Reporting Standards (IFRS), as amended for the UK public sector. In addition, consideration has been given to the *Local Government Pension Scheme Fund Accounts 2016/17 - example accounts and disclosure checklist* published by the Chartered Institute of Public Finance Accountants (CIPFA).

The financial statements also present the net assets available to pay pension benefits. These do not take account of obligations to pay pensions and benefits which fall due after the end of the financial year. Local authorities responsible for administering a pension fund that forms part of the LGPS are required by The Local Government Pension Scheme (Scotland) Regulations 2014 to publish a pension fund annual report, which is required to include a Fund Account and Net Assets Statement prepared in accordance with proper accounting practices.

## 3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### *Fund Account*

#### **Accruals Basis**

In accordance with the Code, the Fund's Financial Statements are generally prepared on an accruals basis. The Net Assets Statement does not include liabilities to pay pensions and benefits after the end of the Fund year and the accruals concept is applied accordingly. Receipts and payments in respect of the transfer of benefits from and to other schemes are treated on a cash basis.

### **Transfers to and from other schemes**

Transfer values represent the amounts received and paid during the year for members who have either joined or left the fund during the financial year and are calculated in accordance with the LGPS Regulations. Individual transfers in/out are accounted for when the member liability is accepted or discharged.

### **Investment Income**

#### **i) Interest income**

Interest is recognised in the Fund Account as it accrues, using the effective interest rate of the financial instrument as at the date of acquisition or origination.

#### **ii) Dividend income**

Dividend income is recognised on the date the shares are quoted ex-dividend. Any income not received by the end of the reporting period is disclosed in the net assets statement as a current financial asset.

#### **iii) Distributions from pooled funds**

Distributions from pooled funds are recognised at the date of issue.

#### **iv) Movement in the net market value of investments**

Changes in the net market value of investments are recognised as income and comprise all realised and unrealised profits/losses during the year.

### **Benefits Payable**

Pensions and lump-sum benefits payable include all amounts known to be due as at the end of the financial year. Any amounts due but unpaid are disclosed in the Net Assets Statement as current liabilities.

### **Taxation**

The Fund is a registered public service scheme under section 1(1) of Sch 36 of the Finance Act 2004 and as such is exempt from UK income tax on interest received and from capital gains tax on the proceeds of investments sold. Income from overseas investments suffers withholding tax in the country of origin, unless exemption is permitted. Irrecoverable tax is accounted for as a Fund expense as it arises.

### **Administration Expenses**

All administration expenses are accounted for on an accruals basis. Central Support Costs from Scottish Borders Council have been recharged to the Fund on the basis of time spent by staff on the service. The recharge includes overheads apportioned to this activity.

### **Investment Management Expenses**

Fees of the external investment managers and custodian are agreed in the respective mandates or subscription agreements governing their appointments. Broadly, these are based on the market value of the investments under their management and therefore increase or reduce as the value of these investments change.

## ***Net Assets Statement***

### **Valuation of Investments**

The values of investments as shown in the net assets statement have been determined as follows:

- Market-quoted investments – Investments listed on recognised Stock Exchanges are valued at the bid price on the closing business day.
- Unquoted investments – Directly held investments include investments in limited partnerships, shares in unlisted companies, trusts and bonds. Other unquoted securities typically include pooled investments in property, infrastructure, debt securities and private equity. The valuation of these pools or directly held securities is undertaken by the investment manager or responsible entity and advised as a unit or security price. The

valuation standards followed in these valuations adhere to industry guidelines or to standards set by the constituent documents of the pool or the management agreement

- Pooled investment vehicles – are valued at bid price on the closing business day

The processes of the fund managers, who are listed in Note 15, page 38 are subject to external audit and verification and this is reported in their respective assurance reports on internal controls (in accordance with Technical Release AAF 01/06).

### **Foreign Currency Transactions**

Dividends, interest and purchases and sales of investments in foreign currencies have been accounted for at the spot market rates at the date of transaction. End of year spot market exchange rates are used to value cash balances held in foreign currency bank accounts, market values of overseas investments.

### **Derivatives**

The Fund uses derivative financial instruments to manage its exposure to specific risks (in particular currency) arising from its investment activities. The Fund does not hold derivatives for speculative purposes.

Derivative contract assets are fair valued at bid prices and liabilities are fair valued at offer prices. Changes in the fair value of the derivative contracts are included in the change in market value.

The future value of forward currency contracts is based on market forward exchange rates at the year-end and determined as the gain or loss that would arise if the outstanding contract were matched at the year-end with an equal and opposite contract.

### **Cash and Cash Equivalents**

Cash comprises cash in hand and demand deposits. Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash and that are subject to minimal risk of change in value.

### **Actuarial Present Value of Promised Retirement Benefits**

The actuarial present value of promised retirement benefits is assessed on a triennial basis by the scheme actuary in accordance with the requirements of IAS 26, calculated in line with IAS 19 and relevant actuarial standards.

The financial statements summarise the transactions of the Fund during the year and its net assets at the year end. They do not take account of the obligations to pay pensions and benefits which fall due after the end of the year. As permitted under the Code, the Fund has opted to disclose the actuarial present value of promised retirement benefits by way of a note to the Net Assets Statement (Note 27, page 48).

### **Additional Voluntary Contributions (AVCs)**

Additional Voluntary Contributions are invested separately from the main Fund, securing additional benefits on a money purchase basis for those members that have elected to contribute. All AVCs are managed by Standard Life and the value at 31 March 2017 was £1.037m (2015/16 £0.846m). During the year contributions totalled £0.153m, while payments out of the AVC fund totalled £0.056m. In accordance with regulation 4(2) (b) of the Government Pension Scheme (Management and Investment of Funds)(Scotland) Regulations 2009 (SI 2009/3093), AVCs are not included in the Pension Fund accounts.



## 4 CRITICAL JUDGEMENTS IN APPLYING ACCOUNTING POLICES

### Unquoted private equity investments

It is important to recognise the highly subjective nature of determining the fair value of private equity investments. They are inherently based on forward-looking estimates and judgements involving many factors. Unquoted private equities are valued by the investment managers using guidelines set out by the British Venture Capital Association. The value of unquoted private equities at 31 March 2017 was £25.2m.

### Pension Fund Liability

The pension fund liability is calculated every three years by the appointed actuary (currently Barnett Waddingham), with annual updates in the intervening years. The methodology used is in line with the accepted guidelines and in accordance with IAS 19. Assumptions underpinning the valuations are agreed with the actuary and are summarised in Note 27 page 47. This estimate is subject to significant variances based on changes to the underlying assumptions.

## 5 PRIOR YEAR ADJUSTMENTS

Work undertaken prior to the implementation of the new finance system on 1<sup>st</sup> April 2017 and the transitional work required during the change of custodian in December 2016 highlighted a number of discrepancies. Further investigation was undertaken resulting in the restatement of the previous year accounts. The table below details the figures restated.

FUND ACCOUNT	2015/16 Published Accounts £000's	2015/16 Restated Figures £000's	Variance  £000's
Investment Income	6,359	6,451	92
Profit and (losses) on disposal of Investments and changes in the Market Value of Investments	(3,519)	(4,282)	763
Closing Net Assets for the Scheme	542,570	541,900	(670)

NET ASSETS STATEMENT	2015/16 Published Accounts £000's	2015/16 Restated Figures £000's	Variance  £000's
Other Current Liabilities	(2,096)	(2,766)	670
Net Assets	542,570	541,900	(670)

NOTE 14 – INVESTMENT INCOME	2015/16 Published Accounts £000's	2015/16 Restated Figures £000's	Variance  £000's
Dividends from Equities	(5,569)	(5,661)	92

NOTE 15 – (PROFITS) AND LOSSES ON DISPOSAL OF INVESTMENTS AND CHANGES IN MARKET VALUE OF INVESTMENTS	2015/16 Published Accounts £000's	2015/16 Restated Figures £000's	Variance  £000's
Unrealised	2,494	3,257	763

## 6 ASSUMPTIONS MADE ABOUT THE FUTURE AND OTHER MAJOR SOURCES OF ESTIMATION OF UNCERTAINTY

The preparation of financial statements requires management to make judgements, estimates and assumptions that affect the amounts reported for assets and liabilities at the balance sheet date and the amounts reported for the revenues and expenses during the year. Estimates and assumptions are made taking into account historical experience, current trends and other relevant factors. However, the nature of estimation means that the actual outcomes could differ from the assumptions and estimates.

The items in the financial statements at 31 March 2017 for which there is a significant risk of material adjustment in the forthcoming financial year are as follows:

Item	Uncertainties	Effect if actual results differ from assumptions
<p>Actuarial Present Value of Promised Retirement Benefits (Note 21)</p>	<p>Estimation of the net liability to pay pensions in the future depends on a number of complex judgements relating to the discount rate used, the rate at which salaries are projected to increase, changes in retirement ages, mortality rates and expected returns on pension fund assets. Barnett Waddingham is engaged to provide the Fund with expert advice about the assumptions to be applied.</p>	<p>The effects on the net pension liability of changes in individual assumptions can be measured.</p> <ul style="list-style-type: none"> <li>- A 0.5% increase in the discount rate assumption would result in a decrease in the pension liability of £44m</li> <li>- A 0.5% increase in the Consumer Price Index assumption for inflation would increase the value of the liabilities by £27m</li> <li>- A 0.5% increase in the long-term rate of salary increase would increase value of the liabilities by £6m, and</li> <li>- A 1.25% increase in assumed life expectancy would increase the deficit by £5m</li> </ul> <p style="text-align: right;"><i>Source – Triennial Valuation 2014</i></p>
<p>Portfolio of alternative assets held in a fund of funds</p>	<p>The alternative assets fund of funds is valued at the sum of the fair values provided by the administrators of the underlying funds plus adjustments that the fund of funds directors or independent administrators judge necessary. The fund of funds is not publically listed and as such there is a degree of estimation involved in the valuation.</p>	<p>The total portfolio of alternative assets held in a fund of funds is valued in the Financial Statements at £98.7m. There is a risk that this investment may be under- or overstated in the accounts.</p>

## 7 EVENTS AFTER THE REPORTING DATE

There are no known events since the 31 March 2017.

## 8 CONTRIBUTIONS RECEIVABLE

2015/16				2016/17		
Employers £'000	Members £'000	Total £'000		Employers £'000	Members £'000	Total £'000
13,373	4,401	17,774	Normal	13,627	4,514	18,141
772	-	772	Special/Pension Fund Strain	202	-	202
-	96	96	Additional Voluntary	-	30	30
<b>14,145</b>	<b>4,497</b>	<b>18,642</b>	<b>Total</b>	<b>13,829</b>	<b>4,544</b>	<b>18,373</b>

## 9 TRANSFERS IN

There were no group transfers in to the scheme during 2016/17 or 2015/16 and the total of £1.074m (2015/16: 0.411m) represents the total of transfer values in respect of individual members joining the scheme.

## 10 BENEFITS PAYABLE

2015/16 £'000		2016/17 £'000
15,234	Pension Payments	15,910
5,123	Lump Sums/Death Benefits	4,076
<b>20,357</b>		<b>19,986</b>

## 11 ANALYSIS OF CONTRIBUTIONS AND BENEFITS

2015/16			2016/17	
Benefits Payable £'000	Contributions Receivable £'000		Benefits Payable £'000	Contributions Receivable £'000
19,340	14,811	Scottish Borders Council	18,868	13,684
261	594	Scheduled Bodies	275	657
756	3,237	Admitted Bodies	843	4,032
<b>20,357</b>	<b>18,642</b>	<b>Total</b>	<b>19,986</b>	<b>18,373</b>

## 12 PAYMENTS TO AND ON ACCOUNT OF LEAVERS

2015/16 £'000		2016/17 £'000
68	Contributions Returned	88
599	Individual Transfers to Other schemes	1,602
<b>667</b>		<b>1,690</b>

### 13 MANAGEMENT EXPENSES

2015/16 £'000		2016/17 £'000
301	Administrative costs	263
2,754	Investment management expenses	3,051
217	Oversight and governance costs	241
<b>3,272</b>	<b>Total</b>	<b>3,555</b>

#### 13(a) INVESTMENT MANAGEMENT EXPENSES

2015/16 £'000		2016/17 £'000
2,543	Management Fees	2,878
-	Performance Related Fees	-
51	Transaction Costs	59
145	Custody Fees	102
15	Other Fees	12
<b>2,754</b>	<b>Total</b>	<b>3,051</b>

### 14 INVESTMENT INCOME

Restated 2015/16 £'000		2016/17 £'000
(5,661)	Dividends from equities	(7,142)
(771)	Income from Pooled Investment Vehicles	(1,133)
(19)	Interest on Cash Deposits	(17)
<b>(6,451)</b>		<b>(8,292)</b>

### 15 (PROFITS) AND LOSSES ON DISPOSAL OF INVESTMENTS AND REALISED CURRENCY PROFITS AND LOSSES

Restated 2015/16 £'000		2016/17 £'000
1,025	Realised	17,514
3,257	Unrealised	92,584
<b>4,282</b>		<b>110,098</b>

### 16 AUDITOR'S REMUNERATION

In 2016/17 the agreed audit fee for the year was £19,710. There were no other fees during 2016/17 paid to Audit Scotland, the Pension Fund's auditor.

## 17 ANALYSIS OF NET INVESTMENT ASSETS

Market Value at 31 March 2016				Market Value at 31 March 2017		
UK £'000	Overseas £'000	Total £'000		UK £'000	Overseas £'000	Total £'000
			<b>Investment Assets</b>			
46,438	157,515	203,953	Equities	53,293	204,219	257,512
			<b>Managed Funds:</b>			
32,546	-	32,546	Property	32,169		32,169
64,089	82,947	147,036	Equities	76,569	105,284	181,853
18,643	-	18,643	Bonds	20,379		20,379
-	39,913	39,913	Diversified Fixed Income		42,814	42,814
-	92,526	92,526	Alternatives		110,322	110,322
3,936	1,778	5,714	Cash Deposits	6,826	1,332	8,158
<b>165,652</b>	<b>374,679</b>	<b>540,331</b>	<b>Total Investment Assets</b>	<b>189,236</b>	<b>463,971</b>	<b>653,207</b>
			<b>Investment Liabilities</b>			
1,447	-	1,447	Derivative - Passive Currency Hedge			
<b>167,099</b>	<b>374,679</b>	<b>541,778</b>	<b>Net Investment Assets</b>	<b>189,236</b>	<b>463,971</b>	<b>653,207</b>

### Alternative asset portfolio at 31 March 2017

The investment in the alternative asset portfolio, managed by LGT Capital Partners and valued at £98.734m at 31 March 2017, is allocated to the following asset classes at 31 March 2016: Convertible Bonds, Emerging Markets Debt, High Yield (Bonds), Commodities, Insurance-Linked Securities, Property, GTAA/Global Macro, Event Oriented, Market Neutral, Thematic Opportunities, Infrastructure and Private Equity.

### Investment Movement Reconciliation

	Opening Market Value £'000	Purchases & Derivative Payments £'000	Sales & Derivative Receipts £'000	Other Movements £'000	Closing Market Value £'000
<b>Investment Assets</b>					
Equities	203,952	46,538	(43,747)	50,769	257,512
<b>Managed Funds:</b>					
Property	32,546	7,888	(3,741)	(4,524)	32,169
Equities	147,036	109	(1,240)	35,948	181,853
Bonds	18,643			1,736	20,379
Diversified Fixed Income	39,913	1,133		1,768	42,814
Alternatives	92,526	11,588		6,208	110,322
<b>Derivative Contracts:</b>					
Passive Currency Hedge	1,447		(1,447)		0
<b>Other Investment balances - Cash</b>	<b>5,715</b>			<b>2,443</b>	<b>8,158</b>
<b>Net Investments</b>	<b>541,778</b>	<b>67,256</b>	<b>(50,175)</b>	<b>94,348</b>	<b>653,207</b>

### Significant Transactions during the year:

Following strategic asset allocation review £11.5m an initial investment was made to Private credit allocation with Alternatives.

### Investments representing more than 5% of Net Assets

The value of the following investments exceeds 5% of the total value of the net assets of the Pension Fund at 31 March 2017. Each of the investments comprises units in a managed fund.

Value as at 31 March 2016	£'000
M&G Alpha Opportunities Fund	42,814
Morgan Stanley Global Brands Fund	105,284
LGT Crown SBC Segregated Portfolio	98,734
UBS UK Passive Equities	74,744

### Investments Analysed by Fund Manager

Investment Management was undertaken on behalf of the Fund during the financial year by seven firms of investment managers: UBS Global Asset Management, Baillie Gifford & Co, Morgan Stanley, Harris Associates and M&G, Partners Group and LGT Capital Partners. The Fund's passive currency hedging programme to December 2017 was provided by State Street Global Advisors. As at 31 March 2016 the market value of the assets under management, broken down by manager and mandate (including cash held within each mandate) was:

31-Mar-16				31-Mar-17	
£'000	%			£'000	%
62,415	11.49	UBS	UK Equities - Passive	74,745	11.44
39,111	7.20	Baillie Gifford	UK Equities	44,112	6.75
120,370	22.16	Baillie Gifford	Global Equities	151,003	23.12
50,278	9.26	Harris	Global Equities	69,221	10.60
82,947	15.27	Morgan Stanley	Managed Fund - Global Equities	105,284	16.12
39,913	7.35	M&G	Managed Fund - Diversified Income	42,814	6.55
18,643	3.43	M&G	Managed Fund - Bonds	20,379	3.12
32,812	6.04	UBS	Property	33,257	5.09
92,337	17.00	LGT	Managed Fund - Alternatives	98,734	15.12
1,447	0.27	State Street	Derivatives - Passive Currency Hedge		
		Partners Group	Managed Fund – Private Credit	11,588	1.77
2,871	0.53	Internal	Internally Managed Cash & Investments	2,070	0.32
<b>543,144</b>	<b>100.00</b>			<b>653,207</b>	<b>100.00</b>

The benchmarks and performance targets for each manager as at the 31 March 2017 are contained in Annex 1, Section 4.3, page 65 for information.

### Fund Performance

The total Fund return for the year was 21.5% including the currency hedging. The hedging arrangements had a negative impact, decreasing the return by 1.4%. Excluding the currency hedging, the return on the Fund was 22.9% with a relative return over benchmark of 2.0%.

Over three years the Fund has generated an annualised return of 10.9% per annum, including the currency hedging, with a relative return over benchmark of 0.9% per annum. Further information on this is contained in the Management Commentary – Review of Investment Performance, page 9.

## 18 STOCK LENDING

As at 31 March 2017 no stock had been released to a third party under a stock lending arrangement.

### 19a FAIR VALUE HIERARCHY

Assets and liability valuations are classified into three levels according to quality and reliability of information used to determine fair values.

- Level 1 are those where fair values are derived from unadjusted quoted prices in active markets for identical assets and liabilities. Products classified as level 1 comprise quoted equities and unit trusts. Prices are quoted at bid prices.
- Level 2 are those where quoted market prices are not available; for example, where an instrument is traded in a market that is not considered to be active, or where valuation techniques are used to determine fair value and where these techniques use inputs that are based significantly on observable market data.
- Level 3 are those where at least one input that could have a significant effect on the instrument's valuation is not based on observable market data. Such instruments would include unquoted equity investments, which are valued using various valuation techniques that require significant judgement in determining appropriate assumptions.

Values as at 31 March 2017	Quoted market price	Using observable inputs	With significant unobservable inputs	Total
	level 1 £'000	level 2 £000's	level 3 £000's	£000's
Designated as fair value through fund account	494,027	34,427	116,547	645,001
Loans & receivables	6,099	5,015	38	11,152
Financial liabilities at fair value through fund account		(1,490)		(1,490)
<b>Net Investment Assets</b>	<b>500,126</b>	<b>37,952</b>	<b>116,585</b>	<b>654,663</b>

Values as at 31 March 2016	Quoted market price	Using observable inputs	With significant unobservable inputs	Total
	level 1 £'000	level 2 £000's	level 3 £000's	£000's
Designated as fair value through fund account	401,671	34,220	98,725	534,616
Loans & receivables	4,295	2,786	1,447	8,528
Financial liabilities at fair value through fund account	-	-	-	-
<b>Net Investment Assets</b>	<b>405,966</b>	<b>37,006</b>	<b>100,172</b>	<b>543,144</b>

## 19b FAIR VALUE TRANSFERS & RECONCILIATIONS

	Market Value 1 April 2016 £'000	Transfers into level 3 £'000	Purchases during year & derivative payments £'000	Sales during the year and derivative receipts £'000	Unrealised gains/ (losses) £'000	Realised gains/ (losses) £'000	Market Value 31 March 2017 £'000
Private Credit	-	11,588	-	-	-	-	11,588
Alternatives	92,526	-	-	-	6,208	-	98,734
Property	3,137	-	-	-	35	-	3,172
Private Equity	3,062	-	-	-	29	-	3,091
Currency Hedge	1,447	-	-	(1,447)	-	-	-
<b>Total</b>	<b>100,172</b>	<b>11,588</b>	<b>-</b>	<b>(1,447)</b>	<b>6,272</b>	<b>-</b>	<b>116,585</b>

Transfers to level 3 reflect the investment into Private Credit following the implementation of the revised Investment Strategy.

Sales during the year reflect the discontinuation of the currency hedge following implementation of the revised Investment Strategy.

## 20 NATURE AND EXTENT OF RISKS ARISING FROM FINANCIAL INSTRUMENTS

### RISK AND RISK MANAGEMENT

The Fund's primary long-term risk is that the Fund's assets will fall short of its liabilities (i.e. promised benefits payable to members). Therefore the aim of investment risk management is to minimise the risk of an overall reduction in the value of the Fund and to maximise the opportunity for gains across the whole Fund portfolio. The Fund achieves this through asset diversification to reduce exposure to market risk (price risk, currency risk and interest rate risk) and credit risk to an acceptable level. In addition, the Fund manages its liquidity risk to ensure there is sufficient liquidity to meet the Fund's forecast cash flows.

Responsibility for managing the Fund's risk rests with the Pension Fund Committee. A risk register for the Fund has been established to identify and analyse the risks that the Fund faces and the key messages from this process are covered in the Risk Management Statement on page 24. The Market Risk and Credit Risk aspects below come under the risk category of Assets and Investment in the Risk Register, whilst Liquidity Risk is a separate category of risk.

In addition, the Funding Strategy Statement and Statement of Investment Principles address risk management considerations as they apply to the particular objectives of each document.

### A) MARKET RISK

Market risk is the risk of loss from fluctuations in equity and commodity prices, interest and foreign exchange rates and credit spreads. The Fund is exposed to market risk from its investment activities, particularly through its equity holdings. The level of risk exposure depends on market conditions, expectations of future price and yield movements and the asset mix. The objective of the Fund's risk management strategy is to identify, manage and control market risk exposure within acceptable parameters, whilst optimising the return on risk.



In general, excessive volatility in market risk is managed through the diversification of the portfolio in terms of geographical and industry sectors and individual securities. To mitigate market risk, the Council and its Investment Consultants undertake appropriate monitoring of market conditions and benchmark analysis.

**(i) Other Price Risk**

Other price risk represents the risk that the value of a financial instrument will fluctuate as a result of changes in market prices (other than those arising from interest rate risk or foreign exchange risk), whether those changes are caused by factors specific to the individual instrument or its issuer or factors affecting all such instruments in the market.

The Fund is exposed to share price risk, arising from investments held by the Fund for which the future price is uncertain. All securities investments present a risk of loss of capital. The maximum risk resulting from financial instruments is determined by the fair value of the financial instruments.

The Fund's investment managers mitigate this price risk through diversification and the selection of securities and other financial instruments is monitored by the Council to ensure it is within limits specified in the Fund investment strategy.

**Other Price Risk – Sensitivity Analysis**

In consultation with the Fund's independent provider of performance and analytical data (WM), it has been determined that the following movements in market price risk are reasonably possible for this reporting period.

Asset Type	Potential Market Movement +/- (% p.a.)
UK Equities	20.2
Global Pooled Equities	20.5
UK Bonds	6.1
Cash	1.1
Property	13.0
Alternatives	17.9

Potential price changes are determined based on the observed historical volatility of asset class returns. The potential volatilities are consistent with a one standard deviation movement in the change in value of the assets over the latest three years. Had the market price of the Fund investments increased/decreased in line with the above, the change in the net assets available to pay benefits in the market price could have been as follows:

Asset Type	Value as at 31 Mar 17 £'000	+/- % Change*	Value on Increase £'000	Value on Decrease £'000
UK Equities	118,857	20.2	142,866	94,848
Global Equities	325,508	20.5	392,238	258,779
Total Bonds	63,193	6.1	67,048	59,338
Cash	2,070	1.1	2,093	2,047
Property	33,257	13.0	37,580	28,934
Alternatives	110,322	17.9	130,070	90,574
<b>Total Assets Exc. Currency Hedge</b>	<b>653,207</b>		<b>771,894</b>	<b>534,520</b>

\*The percentage change for total assets includes the impact of correlation across asset classes.

**(ii) Interest Rate Risk**

The Fund invests in financial assets for the primary purpose of obtaining a return on investments. These investments are subject to interest rate risks, which represent the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

The Fund's interest rate risk is routinely monitored by the Council and its Investment Consultants, including monitoring the exposure to interest rates and assessment of actual interest rates against the relevant benchmarks.

The Fund's direct exposure to interest rate movements as at 31 March 2016 and 31 March 2017 is set out below and includes investment and operational cash balances. These disclosures present interest rate risk based on the underlying financial assets at fair value:

Asset Type	At 31 March 2016 £'000	At 31 March 2017 £'000
Cash and Cash Equivalents	7,080	9,665
Fixed Interest Securities	58,556	63,193
	<b>65,636</b>	<b>72,858</b>

### **Interest rate risk sensitivity analysis**

The Council recognises that interest rates can vary and can affect both income to the Fund and the value of the net assets available to pay benefits.

The analysis that follows assumes that all other variables, in particular exchange rates, remain constant, and shows the effect in the year on the net assets available to pay benefits of a +/- 100 Basis Points (BPS) change in interest rates:

Asset Type	Value as at 31 Mar 17 £'000	Effect on Asset Values	
		Favourable Rate Move + 100 BPS £'000	Unfavourable Rate Move -100 BPS £'000
Cash and Cash Equivalents	9,665	97	(97)
Fixed Interest Securities	63,193	632	(632)
	<b>72,858</b>	<b>729</b>	<b>(729)</b>

### **(iii) Currency Risk**

Currency risk represents the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates. The Fund is exposed to currency risk on financial instruments that are denominated in any currency other than the functional currency of the Fund (£UK). The Fund is invested in equities overseas that are denominated in currencies other than £UK. To help manage this risk, the Fund hedges 50% of its exposure to equities denominated in certain major foreign currencies through the operation of a passive currency overlay programme, operated by State Street.

The following table summarises the Fund's currency exposure at 31 March 2016:

Currency exposure by asset type	As 31 March 2016 £'000	As 31 March 2017 £'000
Overseas Equities	243,370	309,504
Diversified Bonds	39,913	42,814
Alternatives	92,526	110,322
Cash - Foreign Currency	1,778	1,332
<b>Total</b>	<b>377,587</b>	<b>463,972</b>

### Currency Risk – Sensitivity Analysis

Following analysis of historical data in consultation with KPMG the likely volatility associated with foreign exchange movements on an individual currency basis is shown on the table on the following page. The weight of each currency in relation to the total currency basket is multiplied by the change in its exchange rate (relative to GBP) to create the aggregate potential currency change of the 'basket'.

Currency	Value as at 31 Mar 17 £'000	+/- % Change	Value on Increase £'000	Value on Decrease £'000
Australian Dollar	970	12.15%	1,088	852
Brazilian Real	991	17.55%	1,165	817
Canadian Dollar	1,197	10.24%	1,319	1,074
Chinese Yuan	1,886	10.33%	2,081	1,691
Danish Krone	2,404	9.22%	2,625	2,182
EURO *	41,621	9.25%	45,471	37,771
Hong Kong Dollar	4,114	10.29%	4,538	3,691
Japanese Yen *	12,598	15.19%	14,512	10,684
Mexican Peso	2,303	13.54%	2,615	1,991
Norwegian Krone	1,285	11.68%	1,435	1,135
South African Rand	5,005	17.25%	5,868	4,141
South Korean Won	907	14.14%	1,035	779
Swedish Krona	17,402	11.49%	19,402	15,403
Swiss Franc	6,313	12.23%	7,085	5,541
Taiwan Dollar	611	10.01%	672	550
US Dollar	176,184	10.57%	194,807	157,561
<b>Total Currency *</b>	<b>275,791</b>		<b>305,718</b>	<b>245,863</b>

\* The % change for Total Currency includes the impact of correlation across the underlying currencies.

## B) CREDIT RISK

Credit risk represents the risk that the counterparty to a transaction or a financial instrument will fail to discharge an obligation and cause the Fund to incur a financial loss. The market values of investments generally reflect an assessment of credit in their pricing and consequently the risk of loss is implicitly provided for in the carrying value of the Fund's financial assets and liabilities. The selection of high quality counterparties, brokers and financial institutions minimises credit risk that may occur through the failure to settle a transaction in a timely manner.

The Fund is separately mentioned within the Council's Annual Treasury Strategy and this document sets out the Fund's approach to credit risk for internally managed funds. Deposits are not made with banks and financial institutions unless they are rated independently and meet the Council's credit criteria. The Fund has also set limits as to the maximum percentage of the deposits placed with any one class of financial institution.

The Fund believes it has managed its exposure to credit risk, and the Fund has had no experience of default or uncollectable deposits over the past five financial years. The Fund's cash holding under its internal treasury management arrangements at 31 March 2017, including current account cash, was £3.53m (31 March 2016: £2.78m). This was held with the following institutions:

	Rating	Balance at 31 March 2016 £'000	Balance at 31 March 2017 £'000
<b>Money Market Accounts</b>			
Ignis	AAA	355	<b>505</b>
Scottish Widows	AAA	355	<b>505</b>
Blackrock	AAA	355	<b>505</b>
Prime Rate	AAA	355	<b>505</b>
<b>Bank Current Accounts</b>			
Bank of Scotland	A	1,365	1,507
<b>Total</b>		<b>2,785</b>	<b>3,527</b>

### **C) LIQUIDITY RISK**

Liquidity risk represents the risk that the Fund will not be able to meet its financial obligations as they fall due. The Council therefore takes steps to ensure that the Pension Fund has adequate cash resources to meet its commitments.

The Council has immediate access to its internally managed Pension Fund cash holdings through use of instant access accounts or money market funds.

The Fund defines liquid assets as assets that can be converted to cash within three months. Illiquid assets are those assets which will take longer than three months to convert in to cash. As at 31 March 2017, the Fund's only illiquid assets under this definition are some of the Property fund of funds holdings which are only tradable in the secondary market.

## 21 CURRENT ASSETS

	As 31 March 2016 £'000	As 31 March 2017 £'000
<b>Current Assets</b>		
Transfer value receivable (joiners)	330	68
Sundry Debtors	57	104
Prepayments	-	-
<b>Total</b>	<b>387</b>	<b>172</b>

	As 31 March 2016 £'000	As 31 March 2017 £'000
<b>Analysis of Debtors</b>		
Central government bodies	56	17
Other local authorities	181	132
NHS bodies	-	-
Public corporation & trading funds	-	-
Other entities & individuals	150	23
<b>Total</b>	<b>387</b>	<b>172</b>

## 22 CURRENT LIABILITIES

	As 31 March 2016 £'000	As 31 March 2017 £'000
<b>Current Liabilities</b>		
Transfer value receivable (joiners)	30	497
Sundry Creditors		1,138
Benefits payable		464
<b>Total</b>	<b>2,766</b>	<b>2,099</b>

	As 31 March 2016 £'000	As 31 March 2017 £'000
<b>Analysis of Debtors</b>		
Central government bodies		-
Other local authorities	674	211
NHS bodies		12
Public corporation & trading funds		-
Other entities & individuals	2,092	1,876
<b>Total</b>	<b>2,766</b>	<b>2,099</b>

## 23 RELATED PARTY TRANSACTIONS

During the year, the Pension Fund had an average balance of £2.86m (2016: £1.797m) of cash administered by Scottish Borders Council within separate external banking arrangements, which earned interest of £0.006m (2016: £0.010m). The Council charged the Pension Fund £0.333m in respect of expenses incurred in administering the Fund. There are no additional related party

transactions that require to be disclosed. The Pension Fund balance due from Scottish Borders Council to the Pension Fund at the balance sheet date and disclosed in the net assets statement was as follows:

As at 31 March	2016 £'000	2017 £'000
Due (to)/from Scottish Borders Council	(1,486)	104

### Governance

All members of the Pension Fund Committee were active member of the pension fund during 2016/17. None of the Pension Fund Committee were in receipt of pension benefits from the Fund.

## 24 KEY MANAGEMENT PERSONNEL

The key management personnel of the fund is Scottish Borders Council Chief Financial Officer. Total remuneration payable is set out below

31 March 2016 £000's		31 March 2017 £000's
85	Short-term benefits	86
-	Post-employment benefits	
2	Other long-term benefits	2
-	Termination benefits	-
-	Share-base payments	-
<b>87</b>	<b>Total</b>	<b>88</b>

The figures above reflect the full remuneration as reported in Scottish Borders Council Accounts. The Pension Fund is recharged 12% of the above post.

## 25 MEMBERSHIP RECONCILIATION 2016/17

	Membership Reconciliation – Number of Members			
	Contributing Members	Pensioners	Deferred Pensioners	Total
<b>Number at 31 March 2016</b>	<b>4,594</b>	<b>3,157</b>	<b>2,508</b>	<b>10,259</b>
Adjustments (late notifications etc.)	(33)	(1)	(11)	(45)
New Members	530		2	532
Transfers to Other Schemes	(9)		(13)	(22)
Refunds of Contributions	(264)			(264)
Retirement of Contributing Members	(142)	142		0
Transfer to Deferred Pensioners	(258)		258	0
Re-employed Deferred Pensioners	51		(27)	24
Retirement of Deferred Pensioners		64	(64)	0
Dependants' Pensions		43		43
Deaths	(3)	(86)	(1)	(90)
Commutation (trivial pensions)				0
Ill Health Grant				0
End of Entitlement		(5)		(5)
<b>Number at 31 March 2017</b>	<b>4,466</b>	<b>3,314</b>	<b>2,652</b>	<b>10,432</b>

## 26 FUNDING ARRANGEMENTS

In line with the Local Government Pension Scheme Regulations 2014, the Fund's actuary undertakes a funding valuation every three years for the purpose of setting employer contribution rates for the forthcoming triennial period.

The Actuarial Valuation assesses the health of the fund and provides a check that the funding strategy and assumptions used are appropriate.

### The Funding Strategy Statement

The latest Funding Strategy Statement (FSS) (see Annex 1) was approved by the Pension Fund Committee on 22 June 2017 and a copy of this document can be found at: [www.scotborders.gov.uk/pensions](http://www.scotborders.gov.uk/pensions). Key elements of the FSS are the Funding Objectives and Funding Strategy for the Pension Fund and these have been extracted and included below:

#### Funding Objectives (Section 1, page 2 of FSS)

To:

- set levels of employer contribution that will build up a fund of assets that will be sufficient to meet all future benefit payments from the Fund;
- build up the required assets in such a way that produces levels of employer contribution that are as stable as possible;
- ensure effective and efficient management of employer's liabilities; and
- allow the return from investments to be maximised within reasonable risk parameters.

#### Funding Strategy (Section 3, page 4 of FSS)

The funding strategy seeks to achieve (via employee and employer contributions and investment income) two key objectives:

- A funding level of 100%, as assessed by the Fund's appointed actuary, triennially, in accordance with the Regulations; and
- As stable an employer contribution rate as is practical

### 2014 Actuarial Valuation

The 2014 Actuarial Valuation was undertaken for the Fund as at 31 March 2014 (the full report can be seen in Annex 2) and was completed during the financial year 2014/15 by the Fund's actuaries, Barnett Waddingham. It has been undertaken in accordance with Regulation 32 of the Local Government Pension Scheme (Administration) (Scotland) Regulations 2008.

The funding level of the Fund as at the 31 March 2014 was 101%, above the valuation as at 31 March 2011 and this corresponded to a surplus of £2.9m. The following table summarises the funding position.

<b>Past Service Funding Position – Scottish Borders Council Pension Fund</b>		
<b>Valuation Date as at 31 March</b>	<b>2011 £m</b>	<b>2014 £m</b>
Value of the Scheme Liabilities	(402.2)	(487.6)
Smoothed Asset Value	384.8	490.5
<b>Surplus/ (Deficit)</b>	<b>(17.4)</b>	<b>2.9</b>
<b>Funding Level</b>	<b>96%</b>	<b>101%</b>

The value of the scheme liabilities is an estimate of the assets required to pay pensions over the coming years. The smoothed asset value is the contributions received from employers and members as well as investment returns. The surplus or deficit on the Fund is the difference between the two.

The next detailed actuarial valuation will be carried out for the Fund as at 31<sup>st</sup> March 2017.

### **New LGPS Benefits Impact on Benefits Projections**

The Actuarial Valuation Report identified the estimated additional pension and lump sum benefits projected to come into the payments of benefits in each year during the period 1 April 2015 to 31 March 2018 as a result of the changes to the LGPS benefits. These are set out as follows:

<b>Financial year</b>	<b>Additional Retirement Benefits £m</b>	<b>Increase versus 2014/15 Base</b>
2014/15 Base (per Note 8)		19.1
2015/16	3.4	17.8%
2016/17	5.2	27.2%
2017/18	5.4	28.3%

### **Valuation Assumptions**

The valuation of the Fund has been undertaken using the projected unit method under which the salary increase for each member is assumed to increase until they leave active service by death, retirement or withdrawal from service.

#### **Financial Assumptions**

The principal assumptions used in the last triennial valuation (to March 2014) were:

	<b>2011 Valuation</b>		<b>2014 Valuation</b>	
	<b>% p.a.</b>	<b>Real % p.a.</b>	<b>% p.a.</b>	<b>Real % p.a.</b>
Investment Return				
Equities/absolute return funds	6.9	3.4	<b>5.9</b>	<b>2.6</b>
Gilts	4.3	0.8	<b>3.6</b>	-
Bonds	5.5	2.0	<b>4.1</b>	<b>0.5</b>
Property	5.5	2.0	<b>5.5</b>	<b>1.9</b>
Multi Asset Fund	-	-	<b>5.9</b>	<b>2.3</b>
Expense Allowance				
Retail Price Inflation (RPI)	3.5	-	<b>3.6</b>	-
Pay Increases – Long Term	5.0	1.5	<b>4.6</b>	<b>2.0</b>
Pension Increases	3.0	(0.5)	<b>2.8</b>	<b>(0.8)</b>
Discount Rate	6.4	2.9	<b>5.5</b>	<b>1.9</b>

#### **Mortality assumptions**

The mortality assumptions used and applied to all members are those underlying the S1PA mortality tables allowing for Continuous Mortality Investigation (CMI) 2013 projections, with a long term rate of improvement 1.5%.



### Commutation Assumption

It is assumed that future retirees will commute pension to provide a lump sum of 50% of the maximum allowed under HMRC rules.

### Employer Contribution Rates

As part of the 2014 Actuarial Valuation, the actuary certified the common rate of contribution as 18% of payroll for the next three years.

Individual and pooled employers' rates vary from the common contribution rate (18.0%) depending on the demographic and actuarial factors particular to each employer. The table below highlights the key employer contribution rates (i.e. the rate which employers in the Fund pay):

Employers Contribution Grouping	Employers Contribution Rate	
	2015/16	2016/17
Scottish Borders Council Common Pool	18.0%	18.0%
Leisure Trusts Common Pool *	15.5%	15.5%
LIVE Borders		18.0%
Scottish Borders Housing Association – Individual	-	19.0%

\* During the inter-valuation period the Pension Fund Committee agreed, in consultation with the actuary, to reduce the rate for Borders Sport and Leisure Trust in order that they would undertake work to open up the LGPS scheme to their employees again. This was set at 15.5%. The amalgamation of BSLT and the Council Culture services into LIVE Borders however resulted in a revised rate of 18%.

## 27 ACTUARIAL PRESENT VALUE OF PROMISED RETIREMENT BENEFITS

In addition to the Triennial Funding Valuation, the Fund's actuary also undertakes a valuation of pension fund liabilities (actuarial present value of promised retirement benefits) at the accounting date as required by International Accounting Standard (IAS) 26, and calculated in line with IAS 19 assumptions.

This uses the same base data as the Triennial Funding Valuation rolled forward to the current financial year, taking account of changes in membership numbers and updating assumptions to the current year. This valuation is not carried out on the same basis as that used for setting Fund employer contribution rates and the Fund Account does not take account of liabilities to pay pensions and other benefits in the future.

The actuarial present values, calculated in line with IAS 19, are set out in the table below.

	Net Pension Asset as at:		
	31 March 2015 £m	31 March 2016 £m	31 March 2017 £m
Present value of the defined benefit obligations	(716.6)	(696.9)	<b>(906.9)</b>
Fair Value of Fund Assets* (bid value)	537.4	542.7	<b>652.7</b>
Net Asset/(Liability)	(179.2)	(154.2)	<b>(254.2)</b>

This figure is used for statutory accounting purposes by the Fund and complies with the requirements of IAS 26. The assumptions underlying the figure are detailed below:

	At 31 March 2015		At 31 March 2016		At 31 March 2017	
	% p.a.	% p.a.	% p.a.	Real % p.a.	% p.a.	Real % p.a.
Discount Rate	3.3	0.1	3.7	0.4	2.7%	0.0%
Retail Price Inflation (RPI)	3.2	-	3.3	-	2.7%	-
Pay Increases – Long Term	4.2	1.0	4.2	0.9	3.7%	1.0%
Pension Increases	2.4	(0.8)	2.4	(0.9)	2.7%	0.0%

As noted above, the liabilities above are calculated on an IAS 19 basis and therefore will differ from the results of the 2014 Triennial Funding Valuation (see Note 20) because IAS 19 stipulates a discount rate rather than a rate that reflects the market rate for investment returns on the Fund's assets.

## **28 CONTINGENT ASSETS**

One of the admitted body employers in the Pension Fund holds an insurance bond to guard against the possibility of being unable to meet their pension obligations. These bonds are drawn in favour of the Pension Fund and payment will only be triggered in the event of employer default.

## **29 POST BALANCE SHEET EVENTS**

On 23 June 2016, the result of the Referendum on membership of the European Union (EU) was a majority to leave. This resulted in initial volatility in some markets. As the discussions and negotiations continue to proceed, the final effect on investments and inflation on the liabilities remains currently unknown. The Fund's longer term investment strategy may require to be reviewed as the implications of the negotiations become clearer.

## **INDEPENDENT AUDITOR'S REPORT**

### **Independent auditor's report to the members of Scottish Borders Council as administering authority for Scottish Borders Council Pension Fund and the Accounts Commission**

This report is made solely to the parties to whom it is addressed in accordance with Part VII of the Local Government (Scotland) Act 1973 and for no other purpose. In accordance with paragraph 120 of the Code of Audit Practice approved by the Accounts Commission, I do not undertake to have responsibilities to members or officers, in their individual capacities, or to third parties.

### **Report on the audit of the financial statements**

#### **Opinion on financial statements**

I certify that I have audited the financial statements in the annual report and financial statements of Scottish Borders Council Pension Fund for the year ended 31 March 2017 under Part VII of the Local Government (Scotland) Act 1973. The financial statements comprise the Fund Account, the Net Assets Statement and notes to the financial statements, including a summary of significant accounting policies. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union, and as interpreted and adapted by the Code of Practice on Local Authority Accounting in the United Kingdom 2016/17 (the 2016/17 Code).

In my opinion the accompanying financial statements:

- give a true and fair view in accordance with applicable law and the 2016/17 Code of the financial transactions of the fund during the year ended 31 March 2017 and of the amount and disposition at that date of its assets and liabilities;
- have been properly prepared in accordance with IFRSs as adopted by the European Union, as interpreted and adapted by the 2016/17 Code; and
- have been prepared in accordance with the requirements of the Local Government (Scotland) Act 1973, The Local Authority Accounts (Scotland) Regulations 2014, and the Local Government in Scotland Act 2003.

#### **Basis of opinion**

I conducted my audit in accordance with applicable law and International Standards on Auditing in the UK and Ireland (ISAs (UK&I)). My responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of my report. I am independent of the fund in accordance with the ethical requirements that are relevant to my audit of the financial statements in the UK including the Financial Reporting Council's Ethical Standards for Auditors, and I have fulfilled my other ethical responsibilities in accordance with these requirements. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my opinion.

## **Responsibilities of the Chief Financial Officer for the financial statements**

As explained more fully in the Statement of Responsibilities, the Chief Financial Officer is responsible for the preparation of financial statements that give a true and fair view in accordance with the financial reporting framework, and for such internal control as the Chief Financial Officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

## **Auditor's responsibilities for the audit of the financial statements**

My responsibility is to audit and express an opinion on the financial statements in accordance with applicable legal requirements and ISAs (UK&I) as required by the Code of Audit Practice approved by the Accounts Commission. Those standards require me to comply with the Financial Reporting Council's Ethical Standards for Auditors. An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the circumstances of the fund and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Chief Financial Officer; and the overall presentation of the financial statements.

My objectives are to achieve reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK&I) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

## **Other information in the annual report and accounts**

The Chief Financial Officer is responsible for the other information in the annual report and financial statements. The other information comprises the information other than the financial statements and my auditor's report thereon. My opinion on the financial statements does not cover the other information and I do not express any form of assurance conclusion thereon except on matters prescribed by the Accounts Commission to the extent explicitly stated later in this report.

In connection with my audit of the financial statements in accordance with ISAs (UK&I), my responsibility is to read all the financial and non-financial information in the annual report and financial statements to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by me in the course of performing the audit. If I become aware of any apparent material misstatements or inconsistencies I consider the implications for my report.

## **Report on other requirements**

### **Opinions on other prescribed matters**

I am required by the Accounts Commission to express an opinion on the following matters.

In my opinion, based on the work undertaken in the course of the audit:

- the information given in the Management Commentary for the financial year for which the financial statements are prepared is consistent with the financial statements and that report has been prepared in accordance with statutory guidance issued under the Local Government in Scotland Act 2003;
- the information given in the Annual Governance Statement for the financial year for which the financial statements are prepared is consistent with the financial statements and that report has been prepared in accordance with the Delivering Good Governance in Local Government: Framework (2016); and
- the information given in the Governance Compliance Statement for the financial year for which the financial statements are prepared is consistent with the financial statements and that report has been prepared in accordance with The Local Government Pension Scheme (Scotland) Regulations 2014.

### **Matters on which I am required to report by exception**

I am required by the Accounts Commission to report to you if, in my opinion:

- adequate accounting records have not been kept; or
- the financial statements are not in agreement with the accounting records; or
- I have not received all the information and explanations I require for my audit.

I have nothing to report in respect of these matters.

Gillian Woolman MA FCA CPFA  
Audit Scotland  
102 West Port  
Edinburgh  
EH3 9DN

29<sup>th</sup> September 2017



# **SCOTTISH BORDERS COUNCIL PENSION FUND STATEMENT OF INVESTMENT PRINCIPLES 2017**

**Finance  
Chief Executive  
Version: 2017 v1**

## Introduction

This is the Statement of Investment Principles (the SIP) adopted by the Scottish Borders Council to govern the investment operations of its Pension Fund. It covers the matters required by regulations together with certain other aspects of investment management, which it is felt should be included for the sake of completeness.

This version of the SIP was agreed by the Pension Fund Committee (the Committee) on 22 June 2017.

### 1. The statutory requirements concerning the SIP

- 1.1 The Local Government Pension Scheme (Management and Investment of Funds)(Scotland) Regulations 1998 as amended require administering authorities to prepare, maintain and publish a Statement of Investment Principles (SIP) that includes the policy on:
  - The types of investment to be held
  - The balance between different types of investment
  - The risk considerations, including the ways in which risks are to be measured and managed<sup>1</sup>
  - The expected return on investments
  - Realising of investments
  - Taking account of social, environmental or ethical considerations in investments
  - Exercising the rights (including voting rights) attaching to investments
  - Stock Lending<sup>1</sup>
- 1.2 The Statement must also state the extent of compliance with guidance given by the Scottish Ministers. This guidance requires reference to the 6 principles of investment practice published by CIPFA in December 2009.<sup>1</sup>

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<sup>1</sup> “Investment Decision Making and Disclosure in the Local Government Pension Scheme: A Guide to the Application of the Myners Principles (2009)”

## 2. Governance

- 2.1 Scottish Borders Council (the Council) is the Administering Authority for the Local Government Pension Scheme (LGPS) set up for the Scottish Borders geographic area, the Scottish Borders Council Pension Fund (the Fund).
- 2.2 The Council has delegated its pension's functions to the **Pension Fund Committee** (the Committee) which has ultimate responsibility for making decisions in relation to the maintenance and revision of the SIP, and approving decisions in relation to changes in fund manager, investment adviser or custodian.
- 2.3 The **Pension Fund Investment and Performance Sub-Committee** (the Investment Sub-Committee) is a sub-committee established to undertake specific investment monitoring responsibilities as set out in **Appendix 1**.
- 2.4 The **Pension Board** (the Board) is established under the provisions of the Local Government Pension Scheme (Governance) (Scotland) Regulations 2015 with the remit to securing the Fund's compliance with the Regulatory Framework. A constitution has been agreed for the Board with the responsibilities set out in **Appendix 2**.
- 2.5 The SIP sets out the principles governing decisions about the investments of the Fund. The Fund recognises the importance of corporate governance and responsibility in ensuring the long term financial performance of the organisations in which they invest.
- 2.6 The SIP forms part of a governance framework that includes:
  - The Statutory Regulations
  - The Pension Fund Committee
  - The Pension Fund Investment & Performance Sub-Committee
  - The Pension Board
  - The Fund's Advisers
  - The Funding Strategy Statement<sup>22</sup>and
  - The Governance Policy and Compliance Statement<sup>2</sup>.
- 2.7 Underlying the SIP and the Council's related decision making processes is the requirement that the Council must obtain and consider "proper advice" and this is provided by Council Officers and expert, professional advisers under contract to the Council.

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<sup>2</sup> Funding Strategy Statement and Governance Policy and Compliance Statement can be found at [www.scotborders.gov.uk/pensions](http://www.scotborders.gov.uk/pensions)



### 3. The Fund's Objectives

#### Primary Aim

3.1 The primary aim of the Fund is:

*“To provide for members’ pension and lump sum benefits on their retirement or for their dependants’ benefits on death before or after retirement, on a defined benefits basis.”*

In order that this primary objective can be achieved, the following funding and investment objectives have been agreed.

#### Funding Objectives

3.2 The funding objectives are set out in the Funding Strategy Statement (the FSS) and are as follows:

- i To set levels of employer contribution that will build up a Fund of assets that will be sufficient to meet all future benefit payments from the Fund.
- ii To build up the required assets in a way that produces employer contributions, which are as stable as possible.

3.3 The funding objectives must complement the Fund's investment strategy so that the appropriate amount of risk is adopted in the pursuit of investment returns.

## 4. Investment Policy

### Investment Strategy

- 4.1 The Committee sets an Investment Strategy for the Fund, taking into account the funding status and liabilities. The strategy is subject to regular review and, as appropriate, asset liability modelling techniques are used to assist in these reviews.
- 4.2 The Investment Strategy's primary aim is to deliver the funding objective in Section 3.2 ii) above which is to build up the required assets in a way that produces stable employer contributions to the Fund.
- 4.3 The Committee in pursuing this primary aim will, as far as is practicable and as an aid to long-term stability, seek to maintain a positive ratio of assets to liabilities at each actuarial valuation.
- 4.4 The Funding Strategy Statement (FSS) states that the discount rate that is adopted in the actuarial valuation of the Fund's liabilities is derived by considering the expected return from the underlying investment strategy but makes no allowance for additional returns from active management. The strategic benchmark that is established for the Fund's investment strategy is therefore expected to produce a return over the long term in excess of the investment return assumed in the triennial Actuarial Valuations.
- 4.5 The Fund presently has a marginal positive cash flow and currently has more actively contributing members compared to members receiving pensions. It however also has 2,652 deferred members which are currently neither contributing nor receiving – as a result it is not mature and therefore need not, at present, provide a high level of annual income to meet the cost of benefits. It will therefore continue to seek capital growth to meet future liabilities.
- 4.6 The Investment Strategy for the Fund has been developed with the support of external investment consultants who have supported the Committee in their decision making process. The approved investment strategy is presented as a strategic asset allocation which sets benchmark percentage allocations across the various asset classes.
- 4.7 In establishing strategic asset allocations the Committee recognises that it is not possible at reasonable cost to consistently hold investments of a type that maintains an exact match with the Fund's liabilities to pensioners and other members.
- 4.8 The Committee undertook a full review exercise in 2013, taking into account the funding status and liabilities and using asset liability modelling. A further review was again undertaken in August 2016 resulting in the revised strategy contained in this SIP. The Committee will review the strategy, if appropriate, at least once per three year period.
- 4.9 **Appendix 3** contains a summary of the strategic asset allocation benchmark for the Fund.

### Investment Management Arrangements

- 4.10 The Investment Strategy is implemented by employing external investment managers currently UBS Global Asset Management (UBS), LGT Partners (LGT), Morgan Stanley Investment Management (Morgan Stanley), M&G Investments (M&G), Harris Associates (Harris), Partners Group, Blackrock, Permira and Baillie Gifford, as appropriate.
- 4.11 The objective is to employ a combination of managers and investment mandates that will deliver, in aggregate, the target performance for the Fund.

- 4.12 The Committee sets the target for the Fund and this overall target is expressed as an out performance against the Fund's strategic benchmark which is a composite of the various benchmarks for the different managers and asset allocations.
- 4.13 The pursuit of a target implies active management of a substantial part of the Fund and the acceptance of a degree of risk in managing investments.
- 4.14 The Fund's current **total target is to generate a return of at least 2.7% above CPI inflation** assumed as the real discount rate at the actuarial valuation as at 31 March 2014.
- 4.15 The investment managers are responsible for the selection of individual holdings within each type of investment category within the parameters set out in their agreement which includes the need to achieve targets which are measured.
- 4.16 The Fund holds some temporary cash on short term deposit or in money market funds, which are managed by Finance staff.
- 4.17 The Committee determines the distribution of the Fund for investment purposes from time to time.
- 4.18 **Appendix 4** contains details of the investment arrangements that are in place at the 31 March 2015.

## **Risk Measurement and Management**

### **4.19 *Asset Allocation***

- i The key investment risks are recognised as arising from asset allocation. The investment strategy of lowest funding risk would be 100% investment in duration, matched index-linked government bonds, i.e. the most natural "matching" asset for pensions liabilities. However, this is not necessarily the most cost-effective approach.
- ii In the long-term, investment in assets of calculated risk is likely to produce higher returns and therefore reduce the overall cost of funding the pension liabilities. Following this rationale, the Fund deliberately runs an unmatched strategy which is heavily biased towards "growth" assets such as equities, property and other alternative assets.
- iii The asset allocation risks are assessed triennially, typically using asset liability modelling techniques following the actuarial valuation of the Fund, after which the Committee take advice on the continued appropriateness of the existing investment strategy.
- iv As these risks were assessed as part of the asset and liability modelling exercise undertaken in 2016 by the Fund's investment consultant, it is envisaged that this will next be done during 2018/19 following the actuarial valuation as at 31 March 2017.
- v The retrospective impact of investment risk on the Fund's funding position is monitored on a quarterly basis via investment reports prepared by the Fund's investment managers, the Fund's performance monitoring company and the investment consultants.

### **4.20 *Investment Managers***

- i To reduce the risk that the Fund significantly underperforms, performance and risk targets and controls are set for each manager relative to their benchmark. These are set out in formal Investment Management Agreements or Subscription Agreements with each of the appointed managers.

- ii The managers are required to provide data monthly and report quarterly on portfolio management issues. This information is reported to the Committee on a quarterly basis. The monitoring includes assessing their achievement of performance that meets or outperforms their individual targets.
- iii The managers must also provide data to Northern Trust, the company chosen by the Committee to provide it with independent performance comparisons.
- iv The managers are also required to attend at the Pension Fund Investment and Performance Sub-Committee at least once a year to give an account of their activities and performance.
- v The managers must comply with all lawful instructions given to them by the Committee (in accordance with the mandates agreed) and their contracts can be terminated at no more than one month's notice.
- vi All manager mandates will always impose the investment restrictions contained in the Local Government Pension Scheme Regulations.

#### 4.21 *Proper Advice*

- i The Committee is required to secure proper advice to ensure that their decision making processes are appropriately informed. The current advisers to the Fund are:

Investment Consultant	KPMG
Actuaries	Barnett Waddingham

#### 4.22 *Concentration Risk and Diversification*

- i Concentration risk arises from the failure of any investments which constituted a significant proportion of the Fund's assets. In order to reduce this risk a spread of assets is held. The diversification is both within, and across, the major asset classes and will be enhanced through investment in alternative asset classes.
- ii Diversification is used to manage the risk involved in pursuing an active management approach to a substantial part of the fund.
- iii This is achieved through diversification of investment over various types of asset, by the use of at least two managers with different styles or specialism, and by requiring a wide range of individual stocks and shares to be held.

#### 4.23 *Transition Management Arrangements*

- i A specialist transition manager, currently State Street Global Markets (State Street), will be employed to manage complex changes in investment strategy and/or manager(s).
- ii The use of these specialists is intended to reduce the cost of transition to the Fund and minimise the overall impact on the Fund value at the point of transition.

#### 4.24 *Currency Risk*

- i During 2016 the Committee approved the full removal of the Passive Currency Hedging mandate. As long term investors the overseas currency exposure will act as an offset against losses in severely stressed market environments.

#### 4.25 *Safe Keeping of Assets*

- i The services of a global custodian, currently Northern Trust, are employed to ensure the safeguarding of the Fund's assets and ensure that all associated income is collected.
- ii The Fund is provided with statements of assets, cashflow and transactions, which Finance staff reconcile to data reported by the managers.
- iii The custodian also has a responsibility for keeping the Council informed of any concerns arising in its dealings with the investment managers.
- iv Investment in pooled funds managed by UBS, Morgan Stanley, M&G, Partners Group, Blackrock, Permira and LGT gives the Fund a right to the cash value of the units rather than to the underlying assets. The managers of the pooled funds, are responsible for the appointment and monitoring of the custodian of the pooled funds' assets.

#### 4.26 *Cashflow Risk and Realisation of Investments/Liquidity*

- i The overall liquidity of the Fund is considered in the light of potential demands for cash. The Fund will hold sufficient cash to meet the likely benefit payments. Additionally, the Fund will hold sufficient assets in liquid or readily realisable form to meet any unexpected cashflow requirements so that the realisation of assets will not disrupt the Fund's overall policy.
- ii The majority of the Fund's investments are quoted on major stock markets and may be realised relatively quickly if required.
- iii A small proportion of the Fund's investments, in particular Property, and future investments in other alternative assets would take longer to be realised.

## 5. Types of Investment

5.1 The Fund has approval from the Committee to use the following different types of investment and income generating mechanisms to achieve the overall investment objectives:

- Equities (UK, Overseas and Global mandates including direct holdings, Managed Funds, Unit trusts, Investment Trusts, Open Ended Investment Companies)
- Bonds
- Property
- Currency
- Alternative assets such as commodities, hedge funds, infrastructure, emerging market debt, private equity, high yield debt, Private Credit and convertible bonds.
- Cash (including Treasury Bills and Money Market Funds)
- Derivatives and other Managed transactions
- Infrastructure

5.2 Stock Lending is not currently authorised by the Committee for the directly held investments under the custody of its custodian. For the Fund's investments in pooled funds managed by UBS, UBS participate in a stock lending programme where the revenue is reflected in the unit price. UBS AG (the parent company) acts as the principal counterparty so irrespective of the end borrower UBS' counterparty risk is only to UBS AG. Security is provided for the

stock loaned by the borrower transferring ownership of other collateral assets to UBS for the period of the loan.

## 6. Environmental, Social and Corporate Governance Issues

- 6.1 The Committee has an overriding fiduciary duty to maximise investment returns for the benefit of the Fund members. It is aware that in doing so the financial contributions required of Fund employers will be minimised.
- 6.2 The Committee believes that environmental, social and governance issues can affect the financial performance of companies and that it has a responsibility to take these issues seriously and where appropriate, to act upon them.
- 6.3 The Committee considers engagement with companies in which the Fund invests to be the most effective means of understanding and influencing the social, environmental and business policies of those companies. The investment managers for the Fund are therefore encouraged to constructively engage with companies on issues which are consistent with the Fund's fiduciary responsibilities.
- 6.4 The Committee recognises its responsibility to exercise voting rights to ensure transparency and accountability in corporate governance.
- 6.5 The Fund's investment managers maintain close contact with the management of companies in which investments are held or contemplated and subject their affairs to considerable analysis and skilled scrutiny. In recognition of this activity, the Sub-Committee delegates to its managers all voting and other rights attaching to Fund investments.
- 6.6 The investment managers have delegated powers to exercise such rights in the best financial interests of the Fund and would in particular expect them to vote appropriately at company Annual General Meetings (AGMs) and Extraordinary General Meetings (EGMs).
- 6.7 To demonstrate their commitment to ESG Fund Managers are encouraged to sign the United Nations Principles of Responsible Investment (UNPRI) Stewardship Code.
- 6.8 The Committee has, however, drawn the attention of managers to its general concern that the remuneration practices of companies should be patently fair and reasonable. It has asked that managers reflect such concern when voting shares in companies in which the Fund is directly invested. The Committee is content to allow its managers discretion on the voting of in-house pooled fund shares subject to referring any matters relating to the remuneration of Fund managers to it for direction
- 6.9 The key highlights in terms of voting actions taken by investment managers is included as part of the quarterly investment manager report to the Committee its investment consultant.

## 7. Audit responsibilities

- 7.1 The Pension Fund is subject to review by both the Council's external auditors and the Internal Audit team, and comes within the remit of the Council's Audit and Risk Committee.
- 7.2 The external auditors are responsible for reporting on whether the Council's Statement of Accounts gives a true and fair view of the financial position of the Council's Pension Fund, for the year then ended. Their audit report is formally presented to the Council each year. A detailed Annual Report of the Pension Fund is produced in addition and circulated to

employers and other interested parties. This derives information from both audited accounts and unaudited sources of background information.

- 7.3 The Internal Audit team carries out a programme of work designed to re-assure the Chief Executive and Chief Financial Officer that Pension Fund investment systems and records are properly controlled and that Pension Fund assets are safeguarded.

## 8. Compliance with the Myners principles

- 8.1 In October 2008 the Treasury report *Updating the Myners Principles: A Response to Consultation* (October 2008) created the requirement for Local Government Pension Scheme (LGPS) administering authorities to prepare, publish and maintain statements of compliance against a set of six principles for pension fund investment, scheme governance, disclosure and consultation.
- 8.2 In December 2009, CIPFA issued *Investment Decision Making and Disclosure in the Local Government Pension Scheme: A Guide to the Application of the Myners Principles*.
- 8.3 The LGPS regulations require the SIP to contain a statement of compliance with the six principles.
- 8.4 The six principles are:
- i Effective Decision Making
  - ii Clear Objectives
  - iii Risk and Liabilities
  - iv Performance Assessment
  - v Responsible Ownership
  - vi Transparency and Reporting
- 8.5 **Appendix 5** contains this statement of compliance.

## Appendix 1

### Pension Fund Investment and Performance Sub-Committee

The Scheme of Administration for the Council specifies that the following functions shall be referred to the Investment and Performance Sub-Committee:

1. Reviewing the Pension Fund's Statement of Investment Principles.
2. Where appropriate, recommending changes to the Pension Fund Committee in relation to the Statement of Investment Principles.
3. Ensuring appropriate investment management arrangements are in place for monies of the Pension Fund and to review investment manager performance.
4. Overseeing the contractual review of the fund managers and investment adviser(s) and custodian.
5. Where appropriate, making recommendations to the Pension Fund Committee in relation to the appointment or removal of a fund manager, investment adviser or custodian.
6. Overseeing the overall approach to investment risk management and where appropriate recommending changes to the Pension Fund's Risk Register.



## Appendix 2

### Pension Board

The Council approved the Constitution for the Pension Board (the Board) on 2 April 2015.

1. The Objectives of the Board are as follows:

The Board is the body responsible for assisting the Scheme Manager in relation to:

- i Securing compliance with the regulations and other legislation relating to the governance and administration of the Scheme and any statutory pension scheme that is connected with it;
- ii securing compliance with requirements imposed in relation to the Scheme and any connected scheme by the Pensions Regulator; and
- iii such other matters as the regulations may specify .

2. The Board also has the remit to determine the areas they wish to consider including, amongst others:

- d) Reports produced for the Pension Fund Committee;
- e) Seek reports from the Scheme Manager on any aspect of the Fund;
- f) Monitor investments and the investment principles/strategy/guidance;
- g) The Annual Report and Accounts for the Fund;
- h) External voting and engagement provisions in relation to investments;
- i) Pension Fund Administrative Strategy and associated performance;
- j) Actuarial reports and valuations;
- k) Funding Strategy Statement and associated policy; and
- l) Any other matters that the Board deems appropriate within the responsibilities set out in 1 above.

## Appendix 3

### Strategic Asset Allocation

Asset Class	Manager	Strategic Benchmark %	Permitted Range / Tolerance %
<b>UK Equity</b>	UBS <sup>1</sup>	9.0%	
	Baillie Gifford	5.0%	
	<b>Sub Total</b>	<b>14.0%</b>	<b>12% - 16%</b>
<b>Global Equity</b>	Harries Associates	7.0%	
	Baillie Gifford	16.0%	
	Morgan Stanley	10.5%	
	<b>Sub Total</b>	<b>33.5%</b>	<b>30% - 37%</b>
<b>Total Equity</b>		<b>47.5%</b>	<b>42% - 53%</b>
<b>Bonds</b>			
Alpha Opportunities	M&G	10.0%	
Index Linked Gilts		5.0%	
	<b>Total</b>	<b>15.0%</b>	<b>12% - 17%</b>
<b>Alternatives <sup>2</sup></b>			
Multi-Asset Alternatives Fund	LGT Partners	7.5%	
Private Credit	Permira	5.0%	
	Partners Group	5.0%	
Infrastructure		5.0%	
	<b>Total</b>	<b>22.5%</b>	<b>20% - 25%</b>
<b>Property</b>			
Balanced Property	UBS	5.0%	
Long Lease Property	Blackrock	10.0%	
	<b>Total</b>	<b>15.0%</b>	<b>12% - 17%</b>
<b>Cash</b>		0.0%	
<b>Total</b>		<b>100.0%</b>	

**Note:**

<sup>1</sup> This is a passive investment mandate which requires the FTSE All Share index to be tracked.

<sup>2</sup> Alternative assets such as commodities, hedge funds, infrastructure, emerging market debt, private equity, high yield debt and convertible bonds.

## Appendix 4

### Investment Management Arrangements

Asset Class	Manager		Performance Objective (net of fees)	Benchmark Indices Used
<b>UK Equity</b>	UBS	Benchmark Return	+0.0%	FTSE All-Share Index
	Baillie Gifford	Benchmark Return	+1.0%	FTSE All-Share Index
<b>Global Equity</b>	Harries Associates	Benchmark Return	+2.5%	MSCI All Country World Index
	Baillie Gifford	Benchmark Return	+2.5%	MSCI AC World Index
	Morgan Stanley	Benchmark Return	Not Defined	MSCI World Net Index
<b>Bonds</b>				
Alpha Opportunities	M&G *	Benchmark Return	+3.5% - 5%	1 Month LIBOR
Govt Fixed Interest Bonds	M&G	Benchmark Return	+0.75%	FTSE Actuaries UK Conventional Gilts All Stock Index
Corporate Fixed Interest Bonds	M&G *	Benchmark Return	+0.8%	iBoxx Sterling Non-Gilts Index
Index Linked Gilts	TBC	TBC	TBC%	TBC
<b>Multi-Asset Alternatives Fund</b>	LGT Partners	Benchmark Return	+4.0%	LIBOR
	Permira	Benchmark Return	+4.0%	1 month LIBOR (Cash)
	Partners Group	Benchmark Return	+4.0%	1 month LIBOR (cash)
	Infrastructure		+3.5%	RPI
<b>Property</b>	UBS	Benchmark Return	+0.75%	IPD UK PPFI All Balanced Funds Index
	Blackrock	Benchmark Return	+2.5%	RPI

## Statement of Compliance with Myners Principles

This table summarises the principles, best practice guidance as provided by CIPFA and the Fund's current status in relation to compliance .

Principle	Best Practice Guidance	Fund's Current Status
<p><b>1. Effective Decision-Making</b></p> <p>Administering authorities should ensure that:</p> <ul style="list-style-type: none"> <li>• decisions are taken by persons or organisations with the skills, knowledge, advice and resources necessary to make them effectively and monitor their implementation; and</li> <li>• those persons or organisations have sufficient expertise to be able to evaluate and challenge the advice they receive, and manage conflicts of interest.</li> </ul> <p><b>1. Effective Decision-Making (contd.)</b></p>	<ul style="list-style-type: none"> <li>• The administering authority should have a designated committee of members responsible for the management of the pension fund and wherever possible appointments to the committee should take account of relevant skills, experience and continuity.</li> <li>• The committee should have terms of reference, and where investment decisions are delegated the process should be recorded, with the roles of members, officers, advisers and managers specified.</li> <li>• The committee should have appropriate skills for, and is run in a way that facilitates, effective decision-making.</li> <li>• There are sufficient internal resources and access to external resources for the administering authorities and Members to make effective decisions.</li> <li>• It is good practice to have an investment sub-committee, to provide the appropriate focus and skills on investment decision-making.</li> </ul>	<p><b>Full Compliance</b></p> <ul style="list-style-type: none"> <li>• The Fund has a designated committee – the Committee - with the experience and skills to take decisions.</li> <li>• The Committee's terms of reference is contained within the Scheme of Administration for the Council.</li> <li>• The Committee receives training either during meetings or at specific training sessions, including on investment issues.</li> <li>• Induction training is provided for new Members and Officers.</li> <li>• The Committee has an appointed investment consultant to provide specific investment advice.</li> <li>• The Chief Financial Officer and other senior officers provide advice and support to the Sub-Committee</li> <li>• The Investment and Performance Sub-Committee with terms of reference contained within the Scheme of Administration for the Council to enhance the focus on performance monitoring and investment decision making.</li> <li>• The Committee carry out regular reviews of the Fund and compliance with regulations.</li> <li>• The Investment Consultant,</li> </ul>

Principle	Best Practice Guidance	Fund's Current Status
	<ul style="list-style-type: none"> <li>• The committee should obtain proper advice at reasonable intervals from suitably qualified persons.</li> <li>• The Chief Financial Officer should be given responsibility for developing a training plan for committee members.</li> <li>• A business plan should be in place which should include milestones and should review level of resources needed.</li> <li>• Members allowances should be published and reviewed regularly.</li> <li>• Meeting papers should be clear and circulated sufficiently in advance of the meetings.</li> </ul>	<p>Custodian, Actuary, Investment Managers and legal advisers all input into the provision of proper advice. The Investment Adviser attends all meetings of the Committee and Sub-Committee.</p> <ul style="list-style-type: none"> <li>• The Committee's legal advisers and any other relevant parties review any new investment contracts put in place.</li> <li>• There is an approved Training Policy for the Fund and an annual Training Needs Analysis undertaken for all Committee and Board members.</li> <li>• Members' training is the responsibility of the Clerk to the Council with input from the Chief Financial Officer</li> <li>• A business plan was agreed by the Committee on 16 June 2016</li> <li>• Members' Allowances are regularly published as required by the Local Government (Allowances and Expenses) (Scotland) Regulations 2007.</li> <li>• Meeting papers are circulated 7 days in advance of meeting and public papers are published on the Council's internet site.</li> </ul>

Principle	Best Practice Guidance	Fund's Current Status
<p><b>2. Clear Objectives</b></p> <ul style="list-style-type: none"> <li>An overall investment objective(s) should be set out for the fund that takes account of the scheme's liabilities, the potential impact on local tax payers, the strength of the covenant for non local authority employers, and the attitude to risk of both the administering authority and scheme employers, and these should be clearly communicated to advisers and investment managers.</li> </ul>	<ul style="list-style-type: none"> <li>The committee should set an overall investment objective considering the fund's liabilities in the context of net cashflow, the funding position and maturity of liabilities.</li> <li>The desirability of asset liability modelling should be considered.</li> <li>Proper advice should be taken where appropriate.</li> <li>Specialist advice should be sought as to how the objective might be expressed as an expected, or required, rate of return.</li> <li>Peer group benchmarks should be avoided.</li> </ul>	<p><b>Full compliance</b></p> <ul style="list-style-type: none"> <li>The Committee makes decisions on the strategy, structure and managers following advice from their investment consultant, and in doing so periodically considers the results of asset liability modelling and appetite for risk of the administering authority and scheme employers to inform the Investment Strategy.</li> <li>The Fund has a scheme specific benchmark. Investment objectives are stated in the Statement of Investment Principles (SIP). The assets are generally managed under individual mandates where the Committee set the investment managers individual mandate objectives and risk parameters.</li> <li>An explicit mandate is in place with the fund managers which include clear time horizons for performance measurement and evaluation.</li> <li>Both short and long-term performance is measured quarterly against scheme specific benchmarks and the fund managers are required to attend twice per year to discuss performance against those indices.</li> <li>The Committee regularly reviews the investment</li> </ul>

Principle	Best Practice Guidance	Fund's Current Status
<p><b>2. Clear Objectives (contd)</b></p>	<ul style="list-style-type: none"> <li>• Appetite for risk should be considered. Asset allocation decisions should consider all asset classes currently available.</li> <li>• Strategic asset allocation decisions, in particular the equity: bond split, diversification of the assets and why some asset classes may be excluded should be given most attention.</li> <li>• The general and strategic impact of funding levels on tax should be considered and whether sub-funds should be established.</li> <li>• Transaction and transition costs should be fully understood.</li> </ul>	<p>structure of the Fund, including different asset classes, styles of management and follows the appropriate procurement regulations for the appointment of managers which includes a review of cost, objectives and mandates (including risk).</p> <ul style="list-style-type: none"> <li>• The Fund considers the full range of asset classes and has decided to add investments in alternative assets such as private equity, infrastructure, commodities and currencies to its portfolio.</li> <li>• At the time of undertaking the Triennial Actuarial Valuation the Committee considers the impact of funding levels on the contribution levels and therefore on the impact on local taxpayers.</li> <li>• When evaluating new investment managers, the Total Expenses Ratio as well as fees are scored.</li> <li>• As part of any transition the costs are reported to Committee and compared with the target level set prior to transition.</li> </ul>



Principle	Best Practice Guidance	Fund's Current Status
<p><b>3. Risk and Liabilities</b></p> <ul style="list-style-type: none"> <li>In setting and reviewing their investment strategy, administering authorities should take account of the form and structure of liabilities.</li> <li>These include the implications for local tax payers, the strength of the covenant for participating employers, the risk of their default and longevity risk.</li> </ul>	<ul style="list-style-type: none"> <li>The committee should have a clear policy on willingness to accept underperformance due to market conditions.</li> <li>Acceptable tolerances from market index benchmarks returns should be stated.</li> <li>Benchmarks which are absolute in nature or relative to cash returns or RPI might result in underperformance relative to market indices.</li> <li>Overall fund objectives should be expressed in terms which relate to the liabilities.</li> <li>The committee must receive an assessment of the risks associated with their liabilities, valuation and management.</li> <li>The annual report should include an overall risk assessment.</li> </ul>	<p><b>Full compliance</b></p> <ul style="list-style-type: none"> <li>The Committee does not necessarily make changes to the Fund's asset allocation or investment managers due to underperformance, as long as the reasons for this are explained and justified. Advice is taken from the investment consultant regarding any changes to investment policy.</li> <li>Factors affecting long-term performance and advice on how these impact on the Fund are considered as part of the triennial valuation process and when making changes to investment strategy. Advice is received from the Fund's advisors.</li> <li>The overall Fund investment objective is expressed in terms which relate to the liabilities.</li> <li>The Committee carried out an investment strategy review using asset liability modelling in 2016. This involved taking account of the form and structure of the liabilities and aiming to reduce risk where appropriate through increased diversification in the strategies or managing specific risks such as currency risk. It has agreed to undertake a similar review during 2017 following the 2017 Actuarial valuation..</li> <li>The annual report includes a Risk Management Statement</li> </ul>

Principle	Best Practice Guidance	Fund's Current Status
<p><b>3. Risk and Liabilities (contd)</b></p>	<ul style="list-style-type: none"> <li>• The committee should satisfy itself on levels of internal controls. Effective internal controls are a responsibility of the Chief Financial Officer.</li> <li>• The committee should ensure the investment strategy is consistent with the scheme employers ability to pay.</li> </ul>	<ul style="list-style-type: none"> <li>• The Committee regularly review and develop where necessary their internal controls. In addition investment managers provide annual statements on their controls.</li> <li>• The Committee periodically reviews the appropriateness of the investment strategy to achieve the required objectives, taking account of employers ability to pay.</li> </ul>

Principle	Best Practice Guidance	Fund's Current Status
<p><b>4. Performance Assessment</b></p> <ul style="list-style-type: none"> <li>• Arrangements should be in place for the formal measurement of performance of the investments, investment managers and advisers.</li> <li>• Administering authorities should also periodically make a formal assessment of their own effectiveness as a decision making body and report on this to scheme members.</li> </ul>	<p><b>Investments</b></p> <ul style="list-style-type: none"> <li>• The committee should consider the appropriateness of index benchmarks and whether active or passive management is more appropriate, and where active management is felt more appropriate set targets and risk controls.</li> <li>• The mandate provided to each investment manager should cover the investment objective, risk parameters, performance targets and measurement timescales.</li> <li>• Constraints on active managers should not be overly narrow or overly wide.</li> <li>• Investment activity should be monitored and returns measured quarterly in line with regulations, but also over longer time periods.</li> <li>• Variations in returns from the benchmark should be attributed to asset allocation, stock selection, sector selection and currency.</li> </ul> <p><b>Advisers</b></p> <ul style="list-style-type: none"> <li>• Assessment should take account of the extent of decisions delegated.</li> </ul>	<p><b>Full compliance</b></p> <ul style="list-style-type: none"> <li>• The Committee consider, with input from the investment consultant, the suitability of active or passive management for each mandate.</li> <li>• Investment management agreements with each investment manager cover the investment objective, risk parameters, and performance target.</li> <li>• The Strategic Asset Allocation and Investment Management Benchmarks set out the tolerances and performance is considered over 3 – 5 year periods.</li> <li>• The performance of the investment managers is measured quarterly by an independent performance monitoring company.</li> <li>• A comprehensive quarterly performance report is presented to the Committee.</li> <li>• Variations in returns from the benchmark are attributed to asset allocation, stock selection, sector selection and currency within these reports.</li> <li>• The Committee take all significant decisions relating to the management of the Fund. Delegations to officers are contained within the Council's Scheme of Administration or in specific report recommendations.</li> </ul>

Principle	Best Practice Guidance	Fund's Current Status
<p><b>4. Performance Assessment (contd)</b></p>	<ul style="list-style-type: none"> <li>• A framework should be established for assessing actuaries and consultants who should be assessed on a number of factors.</li> </ul> <p><b>Decision making bodies</b></p> <ul style="list-style-type: none"> <li>• The committee's self assessment against expectations should cover manager selection, asset allocation, consultant employment and set out in annual report.</li> </ul>	<ul style="list-style-type: none"> <li>• Factors such as past performance and price are taken into account when re-tendering for external advisers.</li>   <li>• Members all participate in meetings, giving opinions and views where relevant. Each person's view is heard and asked for.</li> </ul>

Principle	Best Practice Guidance	Fund's Current Status
<p><b>5. Responsible Ownership</b></p> <p>Administering authorities should:</p> <ul style="list-style-type: none"> <li>• adopt, or ensure their investment managers adopt, the Institutional Shareholders' Committee Statement of Principles on the responsibilities of shareholders and agents,</li> <li>• includes a statement of their policy on responsible ownership in the Statement of Investment Principles; and</li> <li>• report periodically to scheme members on the discharge of such responsibilities.</li> </ul>	<ul style="list-style-type: none"> <li>• Policies regarding responsible ownership should be disclosed in Statement of Investment Principles contained in the annual report.</li> <li>• The administering authority should consider its approach to environmental, social and governance issues and the potential for engagement in environmental, social and governance issues to add value when formulating investment strategy and selecting investment managers.</li> <li>• The committee should ensure that investment managers have an explicit strategy, setting out the circumstances in which they will intervene in a company.</li> <li>• The committee should ensure its policies are not overridden by an investment manager's general policies.</li> <li>• The committee should ensure that investment consultants adopt the Institutional Shareholder Committee's (ISC) Statement of Practice relating to consultants.</li> <li>• The ISC's Statement of Principles on the</li> </ul>	<p><b>Full compliance</b></p> <ul style="list-style-type: none"> <li>• The Committee are aware of the Institutional Shareholders' Committee Statement of Principles on the responsibilities of Institutional shareholders and have confirmed that their investment managers adopt the Statement of Principles on the responsibilities of shareholders and agents.</li> <li>• The Committee consider environmental, social and governance issues when formulating investment strategy and selecting investment managers but do not give precedent to this factor over other factors which have greater financial implications for the Fund.</li> <li>• The Statement of Investment Principles includes a statement of the Committee's policy on responsible ownership.</li> <li>• Voting on underlying shareholdings is delegated to the fund manager.</li> <li>• Details of the investment manager's house strategy are requested from the manager.</li> <li>• Feedback on interventions to be provided during meeting with manager (minimum of once per annum).</li> <li>• The investment consultant has confirmed that it does adopt the ISC Statement of Practice relating to consultants.</li> </ul>

	responsibilities of Institutional shareholders should be noted.	
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Principle	Best Practice Guidance	Fund's Current Status
<p><b>6. Transparency and Reporting</b></p> <p>Administering authorities should:</p> <ul style="list-style-type: none"> <li>act in a transparent manner, communicating with stakeholders on issues relating to their management of investment, its governance and risks, including performance against stated objectives; and</li> <li>provide regular communication to scheme members in the form they consider most appropriate.</li> </ul>	<p>Reporting ensures that:</p> <ul style="list-style-type: none"> <li>An integrated approach to governance should be built and governance compliance statements should be maintained regularly.</li> <li>The Fund's communication statement must set out the policy on the provision of information, the format and the promotion of the scheme.</li> <li>Examples of good communication from other funds should be sought.</li> <li>Annual report content should be compared to the regulations.</li> <li>Funding strategy statement, statement of investment principles and governance compliance statement should be noted as core sources of information.</li> <li>The governance compliance statement should include information on the extent the administering authority has delegated functions to a committee, and to the extent this complies with CLG guidance.</li> <li>The committee should know its stakeholders and the interests they have.</li> </ul>	<p><b>Full compliance</b></p> <ul style="list-style-type: none"> <li>The Annual Report including the Funding Strategy Statement, Statement of Investment Principles and Governance Statement are published each year.</li> <li>Examples of good communication from other funds are sought.</li> <li>Communications are sent to members whenever important changes to the Fund take place, or to provide updates.</li> <li>The Fund operates transparently and enhances accountability to scheme members.</li> <li>The Fund's Governance Statement includes information on the extent the administering authority has delegated functions to a committee, and to the extent this complies with Scottish Ministers guidance.</li> </ul>

## VERSION CONTROL TABLE

Version	Nature of Amendment	Date of Change	Author
2000 1.0	SIP – created	March 2000	A Bowman
2006 1.0	SIP – update	March 2006	A Bowman
2010 1.0	Draft SIP – updated to reflect updated FSS and new Myners Principles	March 2010	L Mirley in collaboration with Aon Consulting
2010 2.0	Final Draft of SIP to present to Pension Fund Sub-Committee	June 2010	L Mirley
2013 1.0	Final Draft of SIP to present to Pension Fund Committee	Dec 2013	K Robb
DRAFT 2015 1.0	Draft of SIP to present to Pension Fund Committee – updated to reflect new governance arrangements and introduction of Pension Board, and new fund managers	June 2015	L Mirley
DRAFT 2015 2.0	Final Draft of SIP to present to Pension Fund Committee post AON Hewitt Review	June 2015	L Mirley
Draft 2017 1.0	Final draft of SIP to present to Pension Fund Committee on 22 June 2017	June 2017	K Robb

You can get this document on tape, in Braille, large print and various computer formats by contacting the address below. Kirsty Robb can also give information on other language translations as well as providing additional copies.

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**Barnett Waddingham**

# Scottish Borders Council Pension Fund

Actuarial valuation as at 31 March 2014

**Valuation report**

Barnett Waddingham LLP

31 March 2015



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## **Introduction and summary**

### **Purpose of the valuation**

We have carried out an actuarial valuation of Scottish Borders Council Pension Fund (the Fund) as at 31 March 2014, as requested by Scottish Borders Council. The Fund is part of the Local Government Pension Scheme (LGPS).

The valuation was carried out in accordance with Regulation 32 of The Local Government Pension Scheme (Administration) (Scotland) Regulations 2008 (the Regulations) as amended. The main purpose of the valuation is to review the financial position of the Fund and to set the level of future contributions for the employers in the Fund.

This report summarises the results of the valuation and is addressed to Scottish Borders Council as the Administering Authority to the Fund. It is not intended to assist any user other than the Administering Authority in making decisions. Neither we nor Barnett Waddingham LLP accepts any liability to third parties in respect of this report.

This advice is subject to and complies with Technical Actuarial Standards issued by the Financial Reporting Council (in particular, the Pensions TAS and the generic TASs relating to reporting, data and modelling).

### **Results of the valuation**

The results of the valuation are that the past service funding level of the Fund as a whole has increased from 96% to 101% between 31 March 2011 and 31 March 2014. The improvement of the funding position since the previous valuation is mainly due to a combination of good investment returns over the intervaluation period and the deficit contributions paid by the employers.

The common rate of contribution, including payments to target full funding, is 18.0% of pensionable salaries. The individual employer contribution rates, as set out in Appendix 4, are adjusted to take account of this common rate of contribution and each employer's own circumstances. This position reflects an increase in cost of new benefits accruing as a result of an increasing average age profile compared to that at the previous valuation as at 31 March 2011, however this is offset by a decrease in deficit recovery contributions following an improvement in the funding position

We would be pleased to discuss any aspect of this report in more detail.

**Graeme D Muir FFA**

**Alison Hamilton FFA**

## Valuation data

### Data sources

We have used the following items of data as provided by Scottish Borders Council.

Membership extract as at 31 March 2014;

Fund accounts split by employer for the three years to 31 March 2014; and

The results of the previous actuarial valuation as at 31 March 2011.

The data has been checked for reasonableness and any missing or inconsistent data has been estimated where necessary. While this should not be seen as a full audit of the data, we are happy that the data is sufficiently accurate for the purposes of the valuation.

A summary of the data is set out in Appendix 1.

### Assets

The asset allocation of the Fund as at 31 March 2014 was as follows:

Asset allocation of the Fund	31 March 2014	
	£000s	%
UK equities	110,801	23%
Overseas equities	203,308	42%
UK gilts	15,372	3%
Corporate bonds	37,270	8%
Property	21,348	4%
Multi asset fund	83,987	17%
Cash	13,978	3%
<b>Total</b>	<b>486,064</b>	<b>100%</b>

We estimate that the return on the assets in market value terms for the three years to 31 March 2014 was approximately 8.5% p.a.

The current investment strategy is set out in a Statement of Investment Principles dated 4 December 2013.

### Benefits

From 1 April 2015, The Local Government Pension Scheme (Scotland) Regulations 2014 and the Local Government Pension Scheme (Transitional Provisions and Savings) (Scotland) Regulations 2014 will come into effect and replace the current regulations.

The benefits for service from 1 April 2015 will be based on the new regulations and these are summarised in Appendix 5. The main changes are to move from a final salary pension scheme based on 60ths accrual and a retirement age of 65 to a career average revalued earnings pension scheme based on 49ths accrual and a retirement age equal to State Pension Age.

The Local Government Pension Scheme (Transitional Provisions and Savings) (Scotland) Regulations 2014 serve the dual purpose of retaining the previous benefit structure for service up to 31 March 2015 and introducing new protections for members close to retirement to ensure that they are not disadvantaged by the benefit changes.

In this valuation, the funding position for past service is based on the previous regulations in force up to 31 March 2014 and the future service cost is based on the Local Government Pension Scheme (Scotland) Regulations 2014.

We have made no allowance for discretionary benefits awarded throughout the LGPS either by the Government or by employers. Where employers grant discretionary benefits we would expect them to fund the capital value of those benefits at that point.

## Actuarial methods and assumptions

### General valuation approach

We first estimate the future cashflows which will be paid from the Fund for the benefits relating to service up to 31 March 2014 and we do this for all current members and their possible dependants.

We then discount these projected cashflows using the discount rate to get a single figure for the value of the past service liabilities. This figure is the amount of money which, if invested now, would be sufficient to make these payments in future provided that the future investment return was equal to at least the discount rate used.

Various assumptions are needed for the above calculations and these are summarised in Section 4. The financial assumptions such as future inflation and the discount rate are based on smoothed market indicators from around the valuation date, specifically over the six month period from 1 January 2014 to 30 June 2014.

The market value of the assets at 31 March 2014 is then adjusted to also be smoothed over the same six month period so that a consistent comparison can be made with the value of the liabilities. If the value of the smoothed assets is greater than the value of the past service liabilities, there is a surplus; if not, there is a deficit.

Using the same assumptions and a similar methodology we can also calculate the value of the liabilities expected to build up in the future after 31 March 2014 and we do this for each active member. This is then divided by the projected payroll to get a cost of future benefits expressed as a percentage of payroll. After deducting expected employee contributions, this is known as the future service cost and represents the employers' share of the cost of future benefits.

### Multiple calculations

As part of the valuation, we are required to calculate results on an overall Fund level but also for the individual employers.

For the Fund's future service cost, we consider the benefits accruing in the single year following the valuation date.

This is known as the Projected Unit Method and results in a stable, long-term contribution rate over time if the assumptions adopted are borne out in practice and there is a steady flow of new entrants to the Fund. If the admission of new entrants is such that the average age of the membership profile increases then the contribution rate calculated at future valuations would be expected to increase.

At individual employer level we use the Projected Unit Method for active employers in the Fund who are open to new employees. For employers who do not, or do not appear to, allow new employees to join the Fund, we use a method known as the Attained Age Method which assesses the cost of future benefit accrual over all future years rather than just over the next year. This method generally produces a higher level of employer contribution than the Projected Unit Method but, for these closed employers, it should result in less revision in the future.

For closed limited-term employers such as some Transferee Admission Bodies, a modified version of the Projected Unit Method with a control period equal to the remaining term of the contract may be used and this usually gives results between the pure Projected Unit Method and the Attained Age Method.

The amounts that the employer then pays are a combination of the future service cost described above and any adjustments for the past service surplus or deficit.

## **Funding strategy**

Regulation 32 of the Local Government Pension Scheme (Administration) (Scotland) Regulations 2008 states that the actuary must have regard to:

- the existing and prospective liabilities of the Fund arising from circumstances common to all those bodies;
- the desirability of maintaining as nearly constant a common rate as possible; and
- the current version of the Administering Authority's Funding Strategy Statement.

The Funding Strategy Statement states that the key funding objectives are:

- to set levels of employer contribution that will build up a Fund of assets that will be sufficient to meet all future benefit payments from the Fund; and
- to build up the required assets in a way that produces employer contributions, which are as stable as possible.

We can confirm that, in our view, the methods and assumptions adopted meet this requirement.

## Valuation assumptions

As mentioned in the previous section, various assumptions are needed for this valuation.

The principal assumptions are:

- the discount rate - this is based on the expected investment return from the Fund's assets;
- pension increases and deferred revaluation - these are set by the Pension Increase Order which is laid by the Government each year and expected to be linked to the Consumer Prices Index. Benefits earned by active members after 1 April 2015 will also be linked to the Pension Increase Order;
- salary increases - active members' benefits for service before 31 March 2015 will continue to be linked to their final salary; and
- current and future rates of mortality - over the last decade life expectancies have increased more quickly than most predictions so it is important that any assumptions made are as accurate as possible.

The assumptions used for this valuation are based on the expected long-term cost of providing the benefits and we believe that these are suitable for setting the contribution amounts from employers. If an employer leaves the Fund, a different set of assumptions may apply to allow for the crystallisation of their funding obligations. Note that the funding assumptions are also not the same as those that would be used for statutory accounting purposes in employers' accounts.

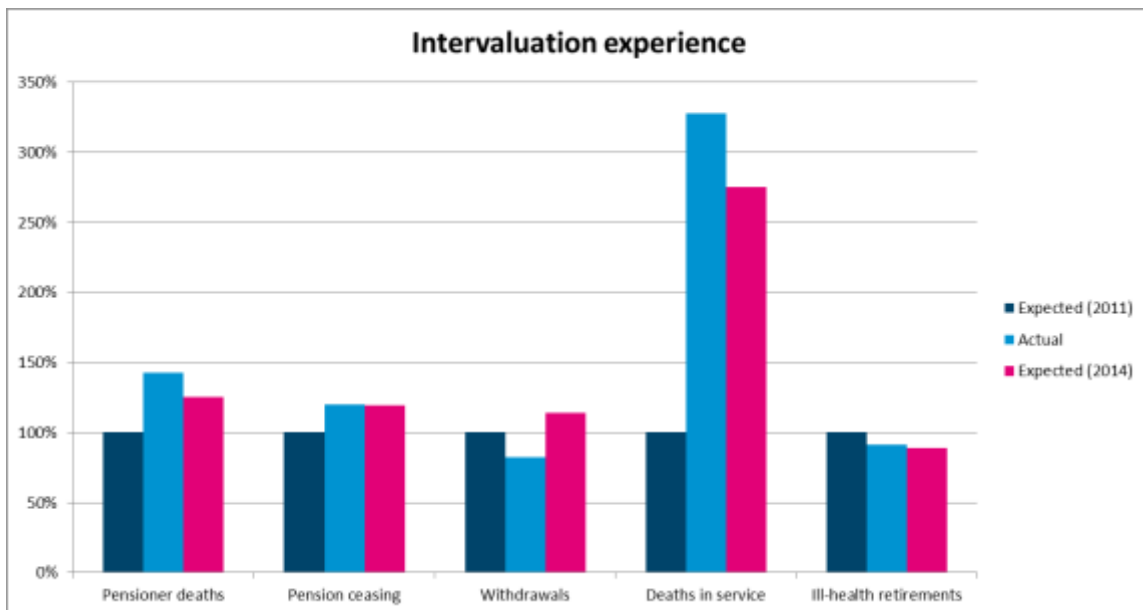
The assumptions and the rationale for them were discussed in our paper to the Administering Authority of 24 November 2014. The final assumptions have been adopted following discussion with the Administering Authority and are as set out in Appendix 2. We confirm that we believe that these are appropriate for the purposes of this valuation.

A comparison of the actual experience with the assumptions adopted at the previous valuation is summarised below:

Intervaluation experience		
	Actual	Expected
Investment return	8.5% p.a.	6.4% p.a.
Pay increases*	1.4% p.a.	5.0% p.a.
Pension increases	3.4% p.a.	3.0% p.a.

\*includes short term overlay

A comparison of the actual demographic experience of members of the Fund over the intervaluation period, with that assumed by the assumptions adopted at the last valuation in 2011 in relative terms is shown in the graph below. The graph also shows how the assumptions adopted for this valuation compare in relative terms with those adopted at 2011.





## Valuation results

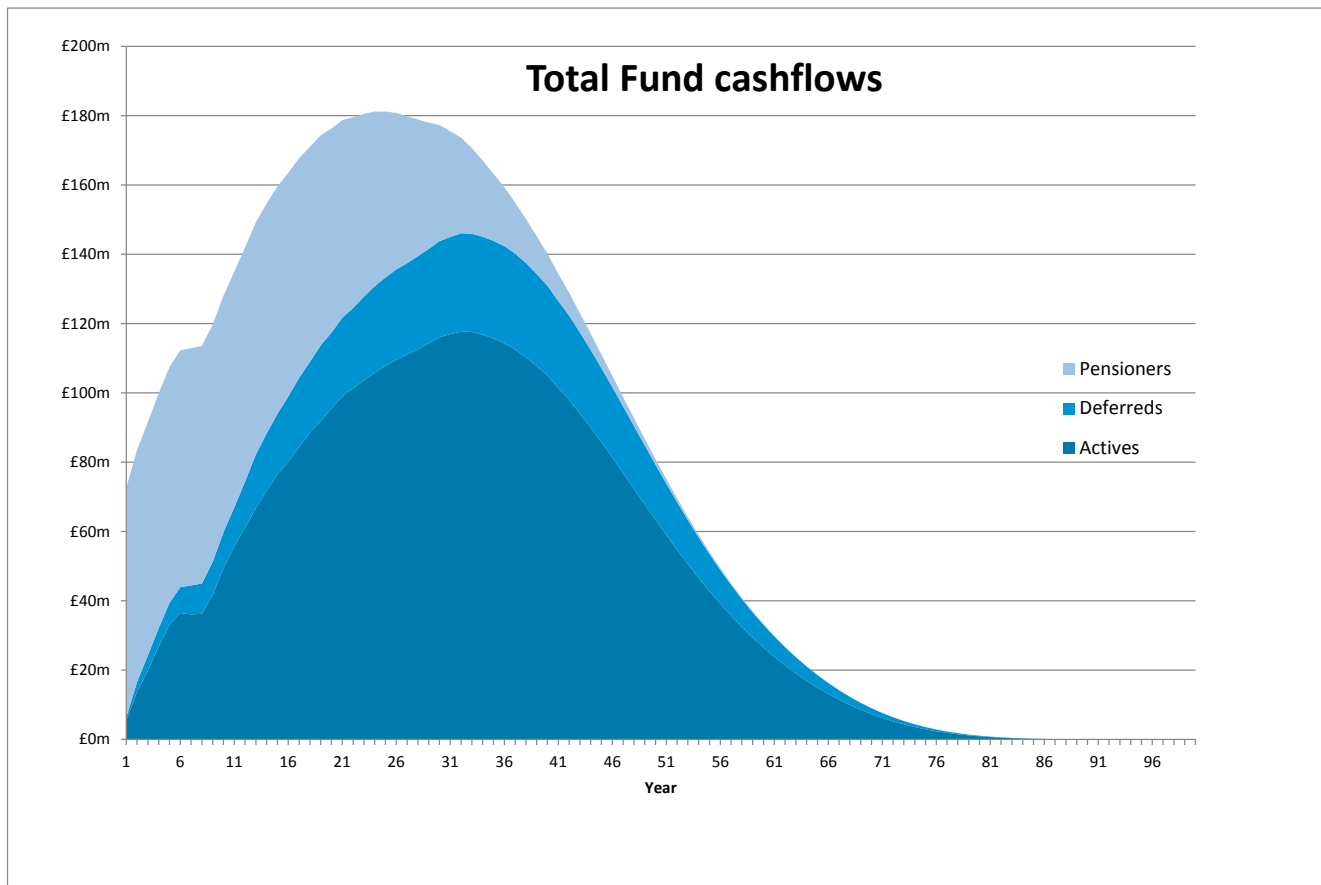
### Previous valuation

The last formal actuarial valuation of the Fund was carried out as at 31 March 2011 by Barnett Waddingham LLP and the results of that valuation were set out in the formal valuation report dated March 2012.

The results of the previous valuation indicated that the assets of the Fund represented 96% of the value of the accrued liabilities of the Fund. The average employer contribution was calculated to be 17.8% of payroll which assumed that the past service funding level would be restored over a period of 12 years.

### Projected cashflows

As mentioned above, the first stage is to project the expected cashflows in relation to past service, which can be charted as follows:



## Past service funding position and contribution rates

The following table sets out the valuation results for the Fund as a whole. We show:

- the past service funding position;
- the required average ongoing employer contribution rate for future service benefits; and
- any deficit contributions required.

Past service funding position	31 March 2014
	£000s
<b>Smoothed asset value</b>	<b>490,477</b>
Active members	221,291
Deferred members	55,281
Pensioner members	211,059
<b>Value of Fund liabilities</b>	<b>487,631</b>
<b>Surplus/(Deficit)</b>	<b>2,846</b>
<b>Funding level</b>	<b>101%</b>
Contribution rates	
Future service cost	18.0%
Deficit recovery	0.0%
<b>Total</b>	<b>18.0%</b>

The contributions payable by each employer are set out in Appendix 4. These are either based on the employer's own membership and experience or they are the employer's share of the contributions payable within a pool of employers.

## Sensitivity analysis

It is important to understand that these results indicate the expected cost of providing the benefits using the chosen method and assumptions. The actual cost of providing the benefits will depend on the future experience.

In order to illustrate this, a number of calculations have been carried out to highlight the sensitivity of the funding position to the assumptions adopted focusing on the assumptions to which the funding position is most sensitive, as shown below:

<b>Change in financial assumption</b>	<b>Approximate effect on deficit</b>
Increase in discount rate of 0.5%	decreases by £44m
Increase in CPI of 0.5%	increases by £27m
Increase in long-term rate of salary increase of 0.5%	increases by £6m
<b>Change in demographic assumption</b>	<b>Approximate effect on deficit</b>
1.25% long-term rate of improvement in mortality projection	decreases by £5m

## Projected future results

The progression of the funding level over time is influenced by a large number of factors including any changes in membership, the investment return achieved and the contributions paid.

We estimate that three years after the valuation date (i.e. at the next valuation) the funding position on the same basis will be 101%. This allows for contributions to be paid as certified and assumes that investment returns and other experience over the next three years are in line with the assumptions described above.

## Neutral estimate

We are also required to consider whether the assumptions used are neutral, that is “not deliberately either optimistic or pessimistic and does not incorporate adjustments to reflect the desired outcome”.

Other than the discount rate, we consider all the assumptions used to be neutral.

We would consider a neutral discount rate to be 6.3% p.a. rather than 5.5% p.a. The higher discount rate results from removing some prudence from the equity return assumption. As a consequence we expect that the future returns from the Fund’s investment strategy will be higher than the valuation discount rate and so we believe that the contributions set for this valuation are more likely to be sufficient to meet the cost of providing the benefits than not.

## Valuation reconciliation

The following table sets out the principal reasons for the change in the funding position since the last valuation:

Change in past service position		
	£000s	£000s
<b>Surplus(Deficit) at 31 March 2011</b>		<b>(17,377)</b>
Benefits accrued	<b>(46,338)</b>	
Early retirements	<b>(3,068)</b>	
Contributions paid	53,913	
<b>Deficit funded (use of surplus)</b>	<b>4,507</b>	
Interest cost	<b>(2,816)</b>	
Asset gain/loss	25,599	
Change in market conditions	<b>(3,189)</b>	
<b>Financial gain(loss)</b>	<b>19,594</b>	
Salary increases	22,310	
Pension increases	<b>(2,443)</b>	
Membership movements	135	
<b>Experience</b>	<b>20,002</b>	
<b>Change in assumptions</b>	<b>(23,880)</b>	
<b>Surplus(Deficit) at 31 March 2014</b>		<b>2,846</b>

As we can see, the main reason for the decrease in deficit is the investment returns being higher than assumed at the previous valuation and the payment of contributions from employers, in particular, the deficit contributions paid by the employers to reduce the deficit.

## Risk and uncertainty

There are many factors that affect the financial position of the Fund, in particular:

**Employer covenant risk** – there is a risk to the Fund that any of the employing bodies may be unable to pay contributions or meet any cessation deficits as they fall due.

The Fund should monitor the strength of each employer in the Fund over time, so that any sudden changes in an employer's position can be mitigated.

**Investment risk** - allowance is made in the assumptions for the expected long-term performance of asset classes such as equities. There is a risk that these returns will not be achieved in practice which may result in further contributions being required. Further, the value of the Fund's assets may not move in line with the value of the Fund's liabilities – mainly because the Fund invests in volatile assets whose value might fall or rise less than expected.

The sensitivity of the valuation results to changes in the investment return assumptions is shown in 5.7 above. The Fund should regularly review their investment strategy to ensure they understand the risks being taken and that those risks are being appropriately managed.

**Inflation** - in projecting the expected future benefit payments, we make assumptions regarding future price inflation. There is a risk that the actual rate of inflation will be higher than assumed which will increase the cost of providing the benefits. This would result in additional contributions being required and a deterioration in the funding position unless investment returns are similarly higher than expected.

The sensitivity of the results to the choice of inflation assumptions is also shown above.

**Mortality** - it is not possible to predict with any certainty how long members of the Fund will live, and if members live longer than expected, additional contributions will be required and the Fund's funding position will deteriorate.

The sensitivity of the results to the choice of mortality assumptions is also shown above. The Fund should review their mortality assumptions at each valuation, taking into account all available evidence, to ensure they remain appropriate for the Fund.

**Member options** - certain benefit options may be exercised by members without the consent of the Fund or the Employer. For example, exchanging pension for cash at retirement or taking a transfer value. The value of the cash benefit is generally expected to be less than the value of the pension exchanged so the funding position would only deteriorate if fewer members than expected took this option. Individual transfer values can be higher or lower than the value of the valuation liabilities, depending on the particular member and market conditions.

**Legislative changes** – there are a number of legislative risks to the Fund and the LGPS in general, including:

All benefits relating to membership after 31 March 2015 will be linked to the individual's State Pension Age;

Contracting-out of the State Second Pension is due to end in 2016 and it is not yet clear what the effect on the LGPS will be;

The potential effects of GMP equalisation between males and females, if implemented, are not yet known;

As part of the changes to the LGPS from 1 April 2015, a cost control mechanism has been implemented so that if the future cost turns out to be higher or lower than expected when the reforms were made, a review of the benefits may be triggered;

If the LGPS was to be discontinued in its current form it is not known what would happen to members' benefits; and

More generally, as a statutory scheme the benefits provided by the LGPS or the structure of the scheme could be changed by the Government.

## Appendix 1 Valuation data

A summary of the membership records submitted for the valuation is as follows.

Active members	Actual pensionable pay				Average		This valuation	
	Number		£000s		£		Average age	Average retirement age
	2014	2011	2014	2011	2014	2011		
Males	1,292	1,372	29,526	31,150	22,853	22,704	48.8	62.5
Females	3,051	2,999	41,764	41,705	13,688	13,906	47.3	63.3
<b>Total</b>	<b>4,343</b>	<b>4,371</b>	<b>71,290</b>	<b>72,855</b>	<b>16,415</b>	<b>16,668</b>	<b>47.8</b>	<b>63.1</b>
Pensioners	Annual Pensions				Average		This Valuation	
	Number		£000s		£		Average Age	
	2014	2011	2014	2011	2014	2011		
Males	1,107	974	8,868	7,206	8,010	7,398		70.5
Females	1,339	1,046	4,156	3,242	3,104	3,099		68.3
Dependants	454	410	1,223	1,031	2,695	2,515		72.0
<b>Total</b>	<b>2,900</b>	<b>2,430</b>	<b>14,247</b>	<b>11,479</b>	<b>4,913</b>	<b>4,724</b>		<b>69.7</b>
Deferred pensioners (including "undecideds")	Annual pensions				Average		This valuation	
	Number		£000s		£		Average age	Average retirement age
	2014	2011	2014	2011	2014	2011		
Males	595	573	1,345	1,229	2,261	2,145	47.6	61.9
Females	1,749	1,535	2,143	1,694	1,225	1,104	47.8	62.8
<b>Total</b>	<b>2,344</b>	<b>2,108</b>	<b>3,488</b>	<b>2,923</b>	<b>1,488</b>	<b>1,387</b>	<b>47.8</b>	<b>62.4</b>

### Notes

The numbers relate to the number of records and so will include members in receipt of, or potentially in receipt of, more than one benefit.

Annual pensions are funded items only and include pension increases up to and including the 2014 Pension Increase Order.

Pensionable pay is actual earnings.

A summary of the revenue accounts for the three years preceding the valuation date is as shown below:

Revenue accounts	Year to	March 2014	March 2013	March 2012	TOTAL
		£000s	£000s	£000s	£000s
Expenditure	Retirement pensions	13,781	13,186	12,026	38,993
	Retirement lump sums	3,449	3,892	5,988	13,329
	Death benefits	-	-	-	-
	Leavers benefits	1,466	1,087	533	3,086
	Expenses	366	278	287	931
	Other expenditure	0	0	0	0
	Total	19,062	18,443	18,834	56,339
Non investment income	Employees ctbns	4,355	4,275	4,559	13,189
	Employers ctbns	12,829	13,398	14,497	40,724
	Transfer values	1,096	918	1,639	3,653
	Other income	0	0	0	0
	Total	18,280	18,591	20,695	57,566
New money for investment		(782)	148	1,861	1,227
Investment income		4,212	4,958	6,142	15,312
<b>Fund value</b>					
Assets at start of year		445,957	393,404	379,339	379,339
Cashflow		3,430	5,106	8,003	16,539
Change in value		36,677	47,447	6,062	90,186
Assets at end of year		486,064	445,957	393,404	486,064
<b>Annual returns</b>					
Approx rate of return (p.a.)		9.2%	13.3%	3.2%	8.5%



## Appendix 2 Actuarial assumptions

A summary of the assumptions adopted in the valuation is set out below:

Future assumed returns at 2014		weighting
Equities	5.9% p.a.	65%
Gilts	3.6% p.a.	3%
Cash	3.4% p.a.	3%
Bond	4.1% p.a.	8%
Property	5.5% p.a.	4%
Multi asset fund	5.9% p.a.	17%
Expense allowance	0.1% p.a.	

Financial assumptions	2014	2011
Discount rate	5.5% p.a.	6.4% p.a.
Retail price inflation (RPI)	3.6% p.a. (20 year point on the BoE Inflation Curve)	3.5% p.a.
Consumer price inflation (CPI)	2.8% p.a. (RPI less 0.8%)	3.0% p.a.
Pension and deferred pension increases	2.8% p.a. (RPI less 0.8%)	3.0% p.a.
Short term pay increases	In line with the CPI assumption for the 2 years to 31 March 2016	Half of the long term assumption for the 2 years to 31 March 2013
Long term pay increases	4.6% p.a. (RPI plus 1% p.a.)	5.0% p.a.

Statistical assumptions	2014	2011
Post retirement mortality		
Current mortality	S2PA tables (100% multiplier for males and 15% for females)	100% of the S1PA tables
Mortality projection	2013 CM1 Model with a long term rate of improvement of 15% p.a.	2011 CM1 Model with a long term rate of improvement of 1% p.a.
Retirement ages	<p>Each member retires at their weighted average "tranche retirement age", i.e. for each tranche of benefit, the earliest age they could retire with unreduced benefits.</p> <p>If the member is over this retirement age, then it is assumed they will retire at their oldest tranche retirement age. If over the oldest tranche retirement age, the member is assumed to have a 1/3 chance of retiring in each of the next 3 years, and it is assumed all members will be retired by age 75.</p>	<p>For each tranche of benefit, active members retire 1 year later than entitled to retire and receive unreduced benefits. Deferred members retire at the earliest age they can receive unreduced benefits.</p> <p>Active and deferred members over these respective ages are assumed to retire immediately.</p>
Proportion married	There is an 80%/70% chance that male/female members will, at retirement or earlier death, have a dependant who is eligible for death benefits.	90% of members are assumed to be married or have an eligible dependant at retirement or earlier death.
Partner age difference	Males are three years older than their spouse and females are three years younger than their spouse.	Males are three years older than their spouse and females are three years younger than their spouse.
Ill-health tiers	50% of ill-health retirements will be eligible for benefits based on full prospective service and 50% will qualify for a service enhancement of 25% of prospective service.	15% of ill-health retirements will be eligible for benefits based on full prospective service and 85% will qualify for a service enhancement of 25% of prospective service.
Commutation	It is assumed that members at retirement will commute pension to provide a lump sum of 50% of the maximum allowed under HMRC rules and this will be at a rate of £12 lump sum of £10 of pension.	It is assumed that members at retirement will commute pension to provide a lump sum of 50% of the maximum allowed under HMRC rules and this will be at a rate of £12 lump sum of £10 of pension.
50/50 scheme allowance	It is assumed that no active members will take up this option.	n/a
Other statistical assumptions	Same as used by Government Actuary's Department when LGPS reforms were designed and based on analysis of incidence of death, retirement and withdrawal for Local Authority Funds.	Based on our analysis of the incidence of pre-retirement death, retirement and withdrawal of our Local Authority client funds.

Sample rates shown below

Incidence per 1000 active members per annum								
Age	Death		Ill Health Retirement		Withdrawal		Salary Scales	
	Males	Females	Males	Females	Males	Females	Males	Females
25	0.1	0.1	0.1	0.1	122.0	144.5	100	100
30	0.2	0.1	0.2	0.1	104.4	122.4	102	101
35	0.3	0.2	0.3	0.3	89.4	103.6	111	105
40	0.5	0.3	0.6	0.5	76.5	87.7	117	108
45	0.8	0.5	1.1	0.8	65.5	74.3	121	110
50	1.3	0.8	2.2	1.6	56.0	62.9	124	110
55	2.1	1.3	4.1	2.9	48.0	53.3	127	110
60	3.4	2.0	7.8	5.3	41.0	45.1	127	110
65	5.4	3.0	14.8	9.8	35.1	38.2	127	110

## Appendix 3 Individual employer data as at 31 March 2014

Employer membership data		Active members			Deferred members			Pensioner members		
Code	Employer	Number	Actual pay £	Average age	Number	Deferred pensions £	Average age	Number	Pensions in payment £	Average age
1	Borders Regional Council	-	-	-	164	241,185	53.0	610	2,448,467	78.3
2	Berwickshire District Council	-	-	-	5	See Note 1	See Note 1	35	116,985	74.0
3	Ettrick and Lauderdale District Council	-	-	-	19	31,602	52.7	72	197,515	77.9
4	Roxburgh District Council	-	-	-	24	37,175	54.5	92	454,307	79.6
5	Tweeddale District Council	-	-	-	15	16,426	51.0	39	169,558	80.8
6	Tweed River Purification Board	-	-	-	4	See Note 1	See Note 1	3	See Note 1	See Note 1
7	Scottish College of Textiles	-	-	-	2	See Note 1	See Note 1	19	96,806	80.2
8	Red Cross Housing Association Ltd	-	-	-	-	-	-	1	See Note 1	See Note 1
10	Project80 Council Burnfoot	-	-	-	-	-	-	1	See Note 1	See Note 1
11	Visit Scotland	1	See Note 1	See Note 1	9	23,743	48.9	7	40,821	63.4
12	Stable Life	-	-	-	1	See Note 1	See Note 1	1	See Note 1	See Note 1
13	Borders College	133	2,136,278	49.0	56	73,013	46.9	41	175,502	66.1
15	Scottish Borders Careers	-	-	-	3	See Note 1	See Note 1	1	See Note 1	See Note 1
16	Scottish Borders Council	3,965	63,832,482	47.8	1,932	2,684,691	47.2	1,887	9,922,978	66.0
17	Berwickshire Housing Association	-	-	-	-	-	-	1	See Note 1	See Note 1
18	B C Business Consultants	-	-	-	22	45,347	50.4	10	24,220	66.0
19	Scottish Borders Housing Association	137	3,289,477	45.8	60	248,774	45.0	63	412,630	65.1
20	Scottish Borders Building Services	-	-	-	-	-	-	-	-	-
21	Jedburgh Leisure Facilities Trust	2	See Note 1	See Note 1	2	See Note 1	See Note 1	-	-	-
22	Borders Sport and Leisure Trust	60	1,142,189	43.7	19	35,850	42.0	6	49,373	64.4
23	Lothian and Borders Community Justice Authority	5	See Note 1	See Note 1	2	See Note 1	See Note 1	1	See Note 1	See Note 1
24	AMEY	10	134,636	56.1	2	See Note 1	See Note 1	2	See Note 1	See Note 1
999	Councillors	30	568,887	61.1	3	See Note 1	See Note 1	8	25,362	69.1

Note 1: Membership details have been excluded for privacy reasons where there are fewer than five members.

## Appendix 4 Rates and adjustment certificate

In accordance with Regulation 32 of the Local Government Pension Scheme (Administration) Scotland Regulations 2008 we have made an assessment of the contributions which should be paid to the Fund by the Fund employers as from 1 April 2015 in order to maintain the solvency of the Fund.

The common rate of contribution payable by each employing authority under Regulation 32 for the period 1 April 2015 to 31 March 2018 is 18.0% of pensionable payroll.

However, each employer pays contributions based on their particular circumstances and so individual adjustments are made. These give the following minimum total contributions as set out below.

		Minimum employer contributions due as a % of salary for the year beginning		
Code	Employer	1 Apr 2015	1 Apr 2016	1 Apr 2017
<b><u>Scottish Borders Council Funding Pool</u></b>				
11	Visit Scotland	18.0%	18.0%	18.0%
13	Borders College	18.0%	18.0%	18.0%
16	Scottish Borders Council	18.0%	18.0%	18.0%
23	Lothian and Borders Community Justice Authority	18.0%	18.0%	18.0%
24	AMEY	18.0%	18.0%	18.0%
<b><u>Leisure Trust Funding Pool</u></b>				
21	Jedburgh Leisure Facilities Trust	15.5%	15.5%	15.5%
22	Borders Sport and Leisure Trust	15.5%	15.5%	15.5%
<b><u>Individual</u></b>				
19	Scottish Borders Housing Association	19.0%	19.0%	19.0%

### Notes

Further sums should be paid to the Fund to meet the costs of any early retirements using methods and assumptions discussed with us.

The certified contribution rates represent the minimum level of contributions to be paid. Employers may pay further amounts at any time and future periodic contributions, or the timing of contributions, may be adjusted on a basis approved by us.

### Projected new benefits

The following table shows the amount of new pension and lump sum benefits (excluding non ill health early retirement benefits) projected to come into payment in each year during the period 1 April 2015 to 31 March 2018.

Year to	Retirement benefits £000s
31/03/2016	3,391
31/03/2017	5,158
31/03/2018	5,369

## Appendix 5 LGPS benefits

The benefit changes from 1 April 2015 involve the formation of a new scheme, referred to below as SLGPS 2015. Transitional regulations are applied so that the benefits in the previous SLGPS 2008 scheme are maintained.

LGPS benefits	SLGPS 2014 REGS		SLGPS 2008 REGS	
<b>Commencement date</b>	1 April 2015		1 April 2009	
<b>Type of scheme</b>	Career Average Revalued Earnings (CARE)		Final Salary	
<b>Pension benefit accrual</b>	1/49 <sup>th</sup>		1/60 <sup>th</sup>	
<b>Revaluation</b>	Consumer Prices Index (CPI)		Based on Final Salary	
<b>Lump sum</b>	By commutation 12:1 up to a maximum of 25% of lifetime allowance			
<b>Pensionable pay</b>	Pay <b>including</b> contractual overtime and additional hours for part time staff			
<b>Member contributions</b>	Tiered contributions based on <b>actual</b> pensionable pay		Tiered contributions based on <b>full time equivalent</b> pensionable pay	
<b>Contribution table (as at 2014)</b>	<b>Earnings range based on actual pensionable pay as at 31 March 2014</b>	<b>Gross contribution rate for 2014/15</b>	<b>Earnings range based on FTE pensionable pay as at 31 March 2014</b>	<b>Gross contribution rate for 2014/15</b>
	Earnings up to and including £20,300	5.5%	Earnings up to and including £20,300	5.5%
	Above £20,300 and up to £24,800	7.25%	Above £20,300 and up to £24,800	7.25%
	Above £24,800 and up to £34,000	8.5%	Above £24,800 and up to £34,000	8.5%
	Above £34,000 and up to £45,300	9.5%	Above £34,000 and up to £45,300	9.5%
	On earnings above £45,300	12.0%	On earnings above £45,300	12.0%
<b>Contribution flexibility</b>	Member can pay 50% contributions for 50% of the pension benefit		Not available	
<b>Normal pension age</b>	Linked to individual member's State Pension Age (minimum age 65)		Age 65	
<b>Death in service lump sum</b>	3 x pensionable pay			
<b>Death in service survivor benefits</b>	1/160 <sup>th</sup> accrual based on Tier 1 ill health pension enhancement			
<b>Ill health provision</b>	Tier 1 - Immediate payment with service enhanced to <b>normal pension age</b>			
	Tier 2 - Immediate payment with 25% service enhancement to <b>normal pension age</b>			
<b>Post retirement revaluation</b>	CPI		CPI (Retail Price Index for pre-2011 increases)	
<b>Vesting period</b>	2 years			

Members who joined the LGPS before 1 April 2015 and after 31 March 2009	
<b>Benefits</b>	Membership built up to 31 March 2015, benefits will be based on a pension of $1/60^{\text{th}}$ x membership x <b>final pay at retirement</b> and the <b>normal pension age</b> applying to the LGPS 2008.
Members who joined the LGPS before 1 April 2009	
<b>Benefits</b>	Membership built up to 31 March 2009, benefits will be based on a pension of $1/80^{\text{th}}$ x membership x <b>final pay at retirement</b> plus an automatic lump sum of 3 times their pension.
<b>Early payment - reduction to benefits (Rule of 85)</b>	For members of the LGPS on 30 November 2006, some or all of their benefits paid early could be protected from reduction under what is called the Rule of 85.
	The Rule of 85 is satisfied if their age at the date they draw their benefits plus their scheme membership (each in whole years) add up to 85 or more.
	If they <b>could not satisfy the Rule of 85 by the time they are 65</b> , then all of their benefits are reduced, if they choose to retire before age 65.
	If they <b>will be age 60 or over by 31 March 2020</b> and choose to retire before age 65, then <b>provided they satisfy the Rule of 85 when they start to draw their pension</b> , the benefits they build up to 31 March 2020 will not be reduced.
	If they <b>will be under age 60 by 31 March 2020</b> and choose to retire before age 65, then <b>provided they satisfy the Rule of 85 when they start to draw their pension</b> , the benefits they have built up to 31 March 2008 will not be reduced.



## GLOSSARY OF TERMS

### ACTIVE MANAGEMENT

An investment management style that seeks to outperform by way of self-selected decisions on stock choice, timing of market incursions, or asset allocation. Compare this with Passive Management.

### ASSET ALLOCATION

The division of the Fund's assets between different classes of assets, for example, UK Equities, Japanese Equities, UK Bonds. In the long run the asset allocation choices should support the Fund's strategic financial objectives. In the short term tactical changes might be made to achieve short-term advantage.

### ALTERNATIVE ASSETS

This is any non-traditional asset with potential economic value that would not be found in a standard investment portfolio. Due to the unconventional nature of alternative assets, valuation of some of these assets can be difficult.

### BALANCED MANAGEMENT

An arrangement under which investments are spread over a range of asset classes at the manager's discretion. The manager controls investments over as many classes as are available under the Fund's overall strategy. Compare this with specialist management.

### BENCHMARK RETURN

This is calculated against the Fund's chosen "benchmarking" group, which comprises a composite of different market indices. The indices in use cover all the markets in which the Fund is invested.

### CONTRIBUTING MEMBER

This is someone who is currently employed by a scheduled or admitted body and is making contributions from pay to the Pension Scheme. Such a person is sometimes referred to as an "active" member.

### DEFERRED MEMBER

This is someone who was once a contributing member and who has chosen to leave his or her accumulated contributions in the Fund to benefit from a pension in due course.

### GROWTH MANAGER

An investment manager who fundamentally believes in picking stocks that he believes will achieve an above-average growth in profits. This is sometimes caricatured as buying stock irrespective of price because the price will rise. Compare this with value manager.

### INVESTMENT MANAGER/FUND MANAGER

A person or organisation that makes investments in portfolios of securities on behalf of clients, in accordance with the investment objectives and parameters defined by these clients

### MANDATE

An agreement between an investment manager and his client as to how investments are to be managed, specifying whatever targets and investment limitations are to apply.

### PASSIVE MANAGEMENT

A style of investment management that seeks performance equal to market returns or to some appropriate index. Such investment entails a more mechanical approach to asset allocation and stock selection because such decisions are largely dictated by general market shifts rather than individual manager discretion. Compare this with active management.

### **PENSIONER/DEPENDENT MEMBER**

This is someone who is receiving benefits from the Fund either as a former contributor or as a dependent of a former contributor who has deceased.

### **POOLED FUND**

A fund in which a number of investors hold units rather than owning the underlying assets. This is a useful way for smaller funds to diversify investments without exposing them to undue risks. Unit Trusts are pooled funds as are Open-ended Investment Companies. Compare this with segregated fund.

### **REALISED GAIN OR LOSS**

Only when an investment is sold does the Fund actually make a profit or loss.

Realised profits and losses are those that have actually arisen via sales throughout the year.

### **RETURN**

The value of capital enhancement and income received by a fund in a year, expressed as a percentage of the opening value of the fund. If values fall "Return" would be negative.

### **RISK**

The danger or chance that returns will vary against benchmarks or targets. If risks are high the expected return should be higher still (the risk premium).

### **SEGREGATED FUND**

The management of a particular fund's assets independently of those of other funds managed by the same investment house. Compare this with a pooled fund.

### **SPECIALIST MANAGEMENT**

The use of a number of managers, each specialising in a particular asset class. Such managers have no say in asset allocation, being only concerned with stock selection.

### **UNREALISED GAIN OR LOSS**

The Statements of Accounts are based on the market value of investments at 31 March 2016. This means that these show what profit or loss would have made if the Fund had sold all its investments on that day. The result is a notional "unrealised" profit or loss.

### **VALUE MANAGER**

A manager who selects stocks that he believes to have potential that is not reflected in the price. This is sometimes caricatured as buying stock because it is cheap. Compare this with growth manager.

### **VESTED/NON VESTED OBLIGATIONS**

Vested obligations refer to employee benefits that are not conditional on future employment. Non vested obligations refer to employee benefits that are conditional on future employment.

### **PENSION FUND STRAIN**

The cost to employers of the early release of pension benefits.

## ADDITIONAL INFORMATION

### Key Documents Online

You can find further information on our website, [www.scotborders.gov.uk/pensions](http://www.scotborders.gov.uk/pensions), including the following documents:

- Funding Strategy Statement
- Annual Report and Accounts
- Governance Policy and Compliance Statement
- Statement of Investment Principles
- Training Policy
- Business Plan 2015/16 to 2017/18
- Actuarial Valuation Statement 2014

### Fund Advisers

<b>Actuaries:</b>	Barnett Waddingham
<b>Auditors:</b>	Audit Scotland
<b>Bankers:</b>	Bank of Scotland
<b>Investment Consultancy:</b>	AON Hewitt to 31 March 2016, KPMG from 12 April 2016
<b>Investment Custodians:</b>	JP Morgan to 30 Nov 2106, Northern Trust from 1 Dec 2016
<b>Investment Managers:</b>	Baillie Gifford, UBS, Morgan Stanley, LGT Partners, M&G, Partners Group and Harris Associates
<b>Additional Voluntary Contributions (AVC) Managers:</b>	Standard Life

### Contact Details

For further information and advice on administration, benefits and scheme membership please contact

Graeme Wilson	Telephone 01835 – 824000	Ext 5341
	E-mail <a href="mailto:gwilson@scotborders.gov.uk">gwilson@scotborders.gov.uk</a>	

*Scheme members should have a copy of the “Employees’ Guide to the Local Government Pension Scheme Administered by the Scottish Borders Council”, and can obtain their own copy of an Annual Report on request.*

or visit Scottish Borders Council Pension Fund website at: [www.scotborders.gov.uk/pensions](http://www.scotborders.gov.uk/pensions)

For further information on the Fund’s investments, please contact

Kirsty Robb	Telephone 01835 – 825249
Capital & Investment Manager	E-mail <a href="mailto:krobb@scotborders.gov.uk">krobb@scotborders.gov.uk</a>

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